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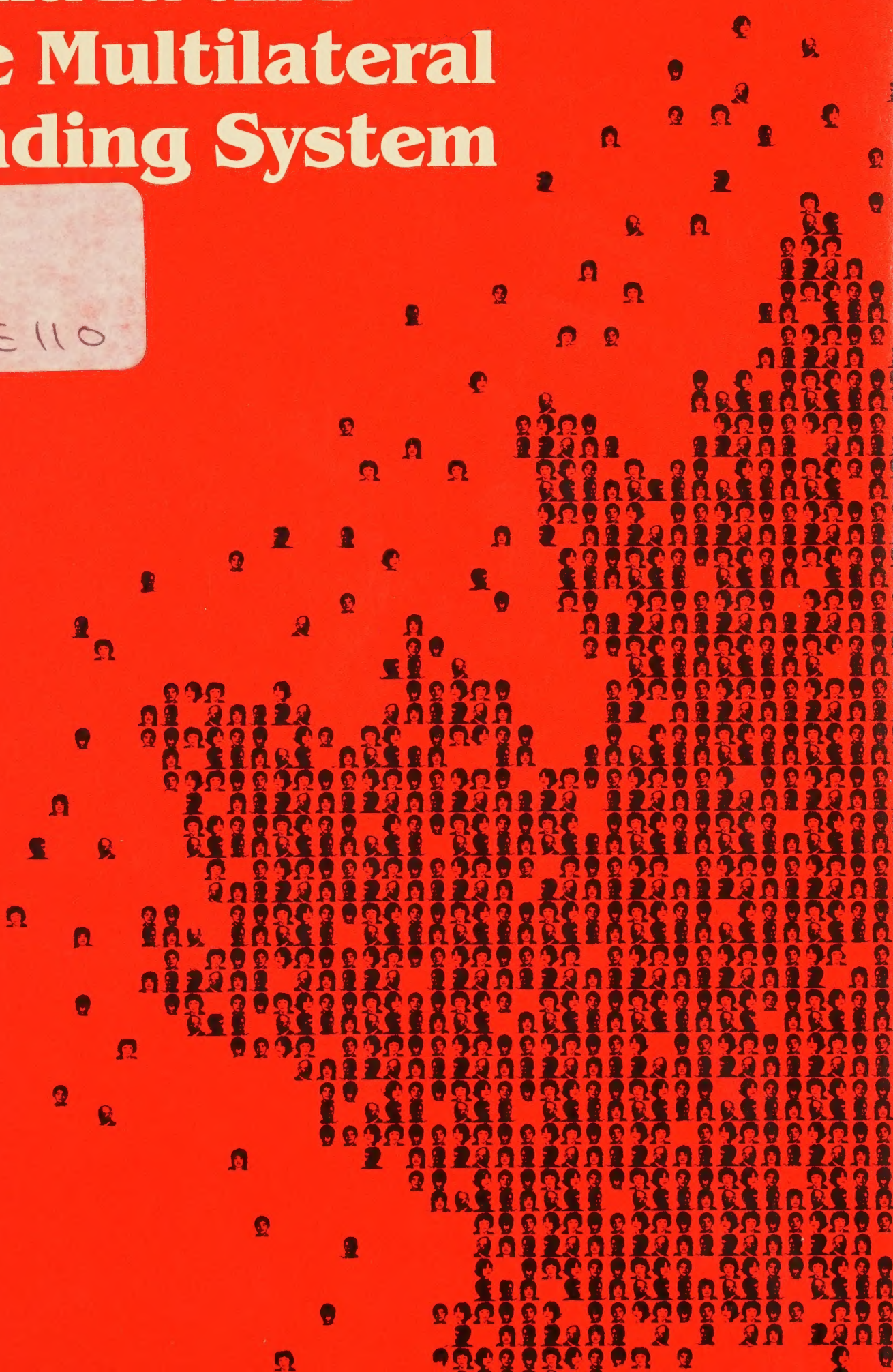




JOHN WHALLEY, Research Coordinator

# Canada and the Multilateral Trading System

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# *Canada and the Multilateral Trading System*

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*This is Volume 10 in the series of studies commissioned as part of the research program of the Royal Commission on the Economic Union and Development Prospects for Canada.*

*The studies contained in this volume reflect the views of their authors and do not imply endorsement by the Chairman or Commissioners.*





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# Canada and the Multilateral Trading System

JOHN WHALLEY  
*Research Coordinator*

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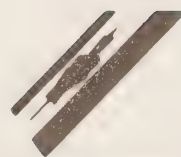
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When the members of the Rowell-Sirois Commission began their collective task in 1937, very little was known about the evolution of the Canadian economy. What was known, moreover, had not been extensively analyzed by the slender cadre of social scientists of the day.

When we set out upon our task nearly 50 years later, we enjoyed a substantial advantage over our predecessors; we had a wealth of information. We inherited the work of scholars at universities across Canada and we had the benefit of the work of experts from private research institutes and publicly sponsored organizations such as the Ontario Economic Council and the Economic Council of Canada. Although there were still important gaps, our problem was not a shortage of information; it was to interrelate and integrate — to synthesize — the results of much of the information we already had.

The mandate of this Commission is unusually broad. It encompasses many of the fundamental policy issues expected to confront the people of Canada and their governments for the next several decades. The nature of the mandate also identified, in advance, the subject matter for much of the research and suggested the scope of enquiry and the need for vigorous efforts to interrelate and integrate the research disciplines. The resulting research program, therefore, is particularly noteworthy in three respects: along with original research studies, it includes survey papers which synthesize work already done in specialized fields; it avoids duplication of work which, in the judgment of the Canadian research community, has already been well done; and, considered as a whole, it is the most thorough examination of the Canadian economic, political and legal systems ever undertaken by an independent agency.

The Commission's research program was carried out under the joint direction of three prominent and highly respected Canadian scholars: Dr. Ivan Bernier (*Law and Constitutional Issues*), Dr. Alan Cairns (*Politics and Institutions of Government*) and Dr. David C. Smith (*Economics*).

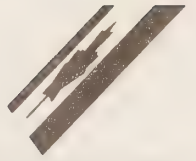
Dr. Ivan Bernier is Dean of the Faculty of Law at Laval University. Dr. Alan Cairns is former Head of the Department of Political Science at the University of British Columbia and, prior to joining the Commission, was William Lyon Mackenzie King Visiting Professor of Canadian Studies at Harvard University. Dr. David C. Smith, former Head of the Department of Economics at Queen's University in Kingston, is now Principal of that University. When Dr. Smith assumed his new responsibilities at Queen's in September, 1984, he was succeeded by Dr. Kenneth Norrie of the University of Alberta and John Sargent of the federal Department of Finance, who together acted as Co-directors of Research for the concluding phase of the Economics research program.

I am confident that the efforts of the Research Directors, research coordinators and authors whose work appears in this and other volumes, have provided the community of Canadian scholars and policy makers with a series of publications that will continue to be of value for many years to come. And I hope that the value of the research program to Canadian scholarship will be enhanced by the fact that Commission research is being made available to interested readers in both English and French.

I extend my personal thanks, and that of my fellow Commissioners, to the Research Directors and those immediately associated with them in the Commission's research program. I also want to thank the members of the many research advisory groups whose counsel contributed so substantially to this undertaking.

DONALD S. MACDONALD





At its most general level, the Royal Commission's research program has examined how the Canadian political economy can better adapt to change. As a basis of enquiry, this question reflects our belief that the future will always take us partly by surprise. Our political, legal and economic institutions should therefore be flexible enough to accommodate surprises and yet solid enough to ensure that they help us meet our future goals. This theme of an adaptive political economy led us to explore the interdependencies between political, legal and economic systems and drew our research efforts in an interdisciplinary direction.

The sheer magnitude of the research output (more than 280 separate studies in 72 volumes) as well as its disciplinary and ideological diversity have, however, made complete integration impossible and, we have concluded, undesirable. The research output as a whole brings varying perspectives and methodologies to the study of common problems and we therefore urge readers to look beyond their particular field of interest and to explore topics across disciplines.

The three research areas, — *Law and Constitutional Issues*, under Ivan Bernier; *Politics and Institutions of Government*, under Alan Cairns; and *Economics*, under David C. Smith (co-directed with Kenneth Norrie and John Sargent for the concluding phase of the research program) — were further divided into 19 sections headed by research coordinators.

The area *Law and Constitutional Issues* has been organized into five major sections headed by the research coordinators identified below.

- Law, Society and the Economy — *Ivan Bernier and Andrée Lajoie*
- The International Legal Environment — *John J. Quinn*
- The Canadian Economic Union — *Mark Krasnick*

- Harmonization of Laws in Canada — *Ronald C.C. Cuming*
- Institutional and Constitutional Arrangements — *Clare F. Beckton and A. Wayne MacKay*

Since law in its numerous manifestations is the most fundamental means of implementing state policy, it was necessary to investigate how and when law could be mobilized most effectively to address the problems raised by the Commission's mandate. Adopting a broad perspective, researchers examined Canada's legal system from the standpoint of how law evolves as a result of social, economic and political changes and how, in turn, law brings about changes in our social, economic and political conduct.

Within *Politics and Institutions of Government*, research has been organized into seven major sections.

- Canada and the International Political Economy — *Denis Stairs and Gilbert Winham*
- State and Society in the Modern Era — *Keith Banting*
- Constitutionalism, Citizenship and Society — *Alan Cairns and Cynthia Williams*
- The Politics of Canadian Federalism — *Richard Simeon*
- Representative Institutions — *Peter Aucoin*
- The Politics of Economic Policy — *G. Bruce Doern*
- Industrial Policy — *André Blais*

This area examines a number of developments which have led Canadians to question their ability to govern themselves wisely and effectively. Many of these developments are not unique to Canada and a number of comparative studies canvass and assess how others have coped with similar problems. Within the context of the Canadian heritage of parliamentary government, federalism, a mixed economy, and a bilingual and multicultural society, the research also explores ways of rearranging the relationships of power and influence among institutions to restore and enhance the fundamental democratic principles of representativeness, responsiveness and accountability.

*Economics* research was organized into seven major sections.

- Macroeconomics — *John Sargent*
- Federalism and the Economic Union — *Kenneth Norrie*
- Industrial Structure — *Donald G. McFetridge*
- International Trade — *John Whalley*
- Income Distribution and Economic Security — *François Vaillancourt*
- Labour Markets and Labour Relations — *Craig Riddell*
- Economic Ideas and Social Issues — *David Laidler*

Economics research examines the allocation of Canada's human and other resources, the ways in which institutions and policies affect this



allocation, and the distribution of the gains from their use. It also considers the nature of economic development, the forces that shape our regional and industrial structure, and our economic interdependence with other countries. The thrust of the research in economics is to increase our comprehension of what determines our economic potential and how instruments of economic policy may move us closer to our future goals.

One section from each of the three research areas — The Canadian Economic Union, The Politics of Canadian Federalism, and Federalism and the Economic Union — have been blended into one unified research effort. Consequently, the volumes on Federalism and the Economic Union as well as the volume on The North are the results of an interdisciplinary research effort.

We owe a special debt to the research coordinators. Not only did they organize, assemble and analyze the many research studies and combine their major findings in overviews, but they also made substantial contributions to the Final Report. We wish to thank them for their performance, often under heavy pressure.

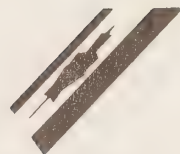
Unfortunately, space does not permit us to thank all members of the Commission staff individually. However, we are particularly grateful to the Chairman, The Hon. Donald S. Macdonald; the Commission's Executive Director, J. Gerald Godsoe; and the Director of Policy, Alan Nymark, all of whom were closely involved with the Research Program and played key roles in the contribution of Research to the Final Report. We wish to express our appreciation to the Commission's Administrative Advisor, Harry Stewart, for his guidance and advice, and to the Director of Publishing, Ed Matheson, who managed the research publication process. A special thanks to Jamie Benidickson, Policy Coordinator and Special Assistant to the Chairman, who played a valuable liaison role between Research and the Chairman and Commissioners. We are also grateful to our office administrator, Donna Stebbing, and to our secretarial staff, Monique Carpentier, Barbara Cowtan, Tina DeLuca, Françoise Guilbault and Marilyn Sheldon.

Finally, a well deserved thank you to our closest assistants: Jacques J.M. Shore, *Law and Constitutional Issues*; Cynthia Williams and her successor Karen Jackson, *Politics and Institutions of Government*; and I. Lilla Connidis, *Economics*. We appreciate not only their individual contribution to each research area, but also their cooperative contribution to the research program and the Commission.

IVAN BERNIER  
ALAN CAIRNS  
DAVID C. SMITH







The present day multilateral trading system is largely based upon the General Agreement on Tariffs and Trade. The GATT contains a series of principles which guide the conduct of trade policy in member countries. The broad objective is to achieve a liberal world trading order based on clear rules firmly adhered to and trade measures which are both visible and transparent.

When the GATT was drawn up in 1947, it was seen as a temporary device designed mainly to record the outcome of a conference arranged to negotiate reductions in tariffs. From these beginnings the GATT has subsequently expanded its coverage, in terms of both member countries and trade policy issues, through a series of multilateral negotiations which have largely defined global trade policies in the postwar world, certainly as far as trade in manufactured products between the developed countries is concerned. As of February 1984, 89 countries were members of the GATT, and 30 countries maintained a *de facto* application of GATT rules.

Canada has always been a strong supporter of the GATT and questions concerning the GATT are central to an evaluation of the options for future Canadian trade policies. Canada has received clear and important gains from its participation in the GATT over the last three decades, particularly in the Kennedy and Tokyo Rounds.

The papers in this volume deal with the current state of the multilateral trading system and the issues and problems that it will face in the years ahead. Three papers are commissioned research studies, three are summaries of the proceedings of research symposia, and four are papers presented at these symposia.

The results of Canadian participation in past GATT rounds and an evaluation of the difficulties currently faced by the multilateral trading system were discussed in a Commission research symposium on the GATT and non-tariff barriers. The proceedings are summarized in two staff papers by Colleen Hamilton and John Whalley. As these papers explain, the underlying theme of the GATT is multilateralism and the GATT embodies a series of key principles as a framework for regulating world trade. One is the nondiscrimination or most-favoured-nation (MFN) principle, which requires that benefits accorded to one member country must be extended to all and that new measures must be applied globally on a non-discriminatory basis. Another key principle is National Treatment — the idea that once across a national border all imported goods should receive the same treatment as that accorded to domestically produced goods.

These principles have guided the seven GATT rounds held since 1947, and Canada has participated fully in all of them. The reductions achieved in trade barriers in the first five rounds were relatively modest — tariff rates were bound and reductions were only achieved in individual tariffs. However, the cumulative effect was significant. Most important, these early rounds established the pattern of multilateralism in trade policy negotiation, and each stage generated the momentum for further liberalization.

Under the sixth round, the Kennedy Round negotiated between 1963 and 1967, more comprehensive steps toward global trade liberalization were achieved. In contrast to the product-by-product negotiations in earlier rounds, a general-purpose formula approach to tariff reductions was adopted. By and large, a 50 percent linear cut approach proposed by the United States was adopted. The participants agreed to grant special status to Canada because linear cuts by Canada would lead to relatively large tariff reductions on price-sensitive imports of manufactures, while price-insensitive exports would receive only modest duty cuts in export markets. Nevertheless, the results of this round had a broad impact on Canada's trade.

In the seventh and most recent round, the Tokyo Round, all participants took part on the same basis. The results for Canada were tariff cuts of an average weighted depth of close to 40 percent on exports to the United States, the European Community and Japan. The resulting reductions in tariffs, which are being phased in from 1980 to 1987, will produce average tariffs on manufactures among developed countries of around 5 to 6 percent by the end of 1987. The average Canadian tariff on dutiable industrial imports will be reduced to between 9 and 10 percent.

In addition, the Tokyo Round has furthered the process of regulating non-tariff measures through codes on government procurement, subsidies and other matters. However, the use of non-tariff measures, especially quotas, voluntary export restraints (VERs) and other quan-



titative restrictions, has proven hard for the GATT to control. This problem is discussed in the paper in this volume by William Diebold, which examines experience with “managed trade” in cotton textiles, steel and autos. Most of these arrangements are the result of negotiations between importing and exporting governments and, for the most part, lie outside the present system of multilateral GATT rules. While international agreements covering trade in textiles come under multilateral surveillance to some extent, this has not been the case with VERs and Orderly Marketing Agreements. Diebold offers some proposals for dealing with these more adequately under a multilateral framework.

A further area where the GATT system is widely acknowledged to be weak is the limited extent to which it has encouraged active participation by developing countries in the conduct of world trade. Many of the most protectionist tariff and non-tariff measures in developed countries, for instance, are currently directed against the exports of developing and newly industrializing countries. Also, to the extent that international trading arrangements are in disarray, the interests of smaller and trade-dependent countries are adversely affected. This holds true for Canada as well as for many smaller industrial and industrializing countries, giving Canada a common interest with these countries in a healthy and orderly system of world trade. These themes are explored in a symposium paper by Margaret Biggs on the developing countries and the international trading system and in a commissioned research paper by Gerald Helleiner.

Helleiner examines Canada’s economic relations with developing countries and suggests that neither Canadian trade policies nor Canadian aid policies have lived up to the rhetoric surrounding them. He argues that while Canadian trade policies have not been more protectionist or discriminatory than those of other industrialized countries, penetration of Canadian markets by the exports of developing countries has been relatively small. Canadian aid performance has been weakened by the substantial degree to which it is tied to Canadian procurement. Helleiner calls for a separation of development objectives from commercial objectives in our financial relations with these countries.

The possible content of a future multilateral trade negotiation (MTN) under the GATT has also been explored in the Commission’s research activity. The research symposia, including one on Canada and the future of the global trading system, reviewed the unfinished business from the Tokyo Round as well as further issues that would likely arise in another MTN. A staff paper by Colleen Hamilton and John Whalley summarizes the symposium proceedings.

The symposium paper by Michael Aho reviews the key issues. Aho discusses the prospects for progress on issues affecting North-South trade, on safeguards and adjustment policies affecting basic industries, and on current problems with counterfeit goods and trademark viola-

tions. He also reviews recent proposals to negotiate rules to govern trade in services.

The issue of extending multilateral rules to cover service trade is analysed in a commissioned paper by Rodney Grey. Grey argues that the GATT itself is in some disarray as a set of rules, and sees many problems in attempting to use it as a framework for rules to cover trade in services. In his view there are problems of greater importance for trade policy makers' attention — agriculture, textiles, clothing and steel, to name a few.

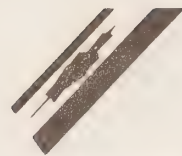
The options for Canadian trade policy, given the changing nature of the world economy and the on-going developments in trade arrangements, are enumerated in a commissioned research paper by John Curtis. He examines the variety of bilateral and multilateral trade policy options available to Canadian policy makers.

A separate paper by Ronald Wonnacott deals with one of these options — a Canada-Japan free trade agreement. Such an arrangement might seem attractive, given the frequent discussion in the past of the merits of diversifying Canada's trade. However, Wonnacott argues that the gains would likely be fairly small when compared to the potential costs. These costs would come from trade diversion and, perhaps more importantly, from the disruptive effect such an arrangement could have on our existing trade arrangements with the United States. In Wonnacott's view it would be preferable to negotiate a free trade arrangement with both Japan and the United States.

As the papers in this volume make clear, exactly how Canada's trade interests have been furthered through the GATT, and how they may be affected in any future GATT round, remains a subject for debate. The perception is strongly entrenched in Canada that the GATT has served us well by allowing for increased access to export markets abroad and by providing for discipline in world trade. How much further access can be obtained through this route? What are the alternatives for our trade policies? These are some of the key issues in deciding how we should approach our participation in the GATT in the years ahead.

JOHN WHALLEY





Many people were involved in the trade policy research effort in the economics branch of the Commission's research program and we would like to acknowledge their help. The Commission's Research Advisory Group on Trade Policy (Economics) provided valuable assistance in selecting the topics to be covered and in commenting on papers and on the issues before the Commission. They also participated extensively in the research symposia held by the Commission on trade policy topics.

The following were the members of the group: Peter Cornell (Economic Council of Canada), John Curtis (Institute for Research on Public Policy), Richard G. Harris (Queen's University), Gerald K. Helleiner (University of Toronto), James Markusen (University of Western Ontario), Ronald McKinnon (Stanford University), A. Edward Safarian (University of Toronto), Ronald Shearer (University of British Columbia), Rodrigue Tremblay (University of Montreal), Bruce W. Wilkinson (University of Alberta) and Ronald Wonnacott (University of Western Ontario).

We are grateful for the assistance of the Commission's economic research staff, particularly Dr. I. Lilla Connidis, Barbara Cowtan, Tina De Luca, Donna Stebbing and Marilyn Sheldon, and Donald Wilson of the Institute for Research on Public Policy. We also acknowledge the support and guidance of David Smith, John Sargent and Kenneth Norrie, co-directors of research in economics for the Commission. We are particularly grateful to Ruth Crow, the editor of the economics volumes on trade policy.

J. W.







# The GATT and Canadian Interests

## *Summary of the Proceedings of a Research Symposium*

COLLEEN HAMILTON AND  
JOHN WHALLEY

Since 1947, changes in the global trading system have largely reflected the multilateral approach toward trade liberalization represented by the General Agreement on Tariffs and Trade (GATT) and the rounds of negotiations that have taken place within the GATT framework. Canada has always been a staunch supporter of the GATT, and therefore Canada's questions concerning the GATT are a dominant issue in evaluating options for future trade policies.

The wide range of issues involved with Canada's participation in the GATT was discussed as part of a one-day symposium, "The GATT and Canadian Interests," held on December 2, 1983 by the Royal Commission on the Economic Union and Development Prospects for Canada. Participants are listed in Appendix A. Papers on the GATT were presented by John Weekes of the Department of External Affairs, Government of Canada, and Frank Stone of the Institute for Research on Public Policy, Ottawa. Jan Tumlr of the GATT Secretariat prepared a series of comments which were distributed to participants but not formally presented. A panel discussion followed. Panel members included Peter Williams of the GATT Secretariat; W. Douglas Newkirk of the United States Trade Representative's Office, Washington; and Messrs. Weekes and Stone. This paper summarizes some of the main themes emerging from the papers and the discussion.

Canada has participated actively in the various GATT negotiating rounds since 1947. In the past two rounds, the Kennedy and Tokyo rounds, major advances were made on the trade liberalization front. Recently, however, this approach to trade policy making has come under re-examination in a number of quarters. In the trade policy community, both within Canada and abroad, there is widespread concern that global

trade policy making may be unable to continue as in previous decades. Membership in the GATT has grown substantially and difficulties have arisen in negotiating new trade arrangements. The GATT has had limited success in regulating proliferating non-tariff measures. Its present dispute settlement procedure is no longer considered a fully effective method of ensuring compliance of members to the GATT codes. These problems have been further compounded by the sense of the developing countries that their interests have been largely excluded from GATT negotiations.

We are thus at a critical juncture in regard to the future of the GATT. On the one hand, there are growing indications that the United States and other larger powers may take initiatives that could lead to a new GATT round, perhaps as early as 1986. Although many tariffs were substantially reduced in previous GATT rounds, the sense is that a new round would focus on a number of outstanding topics of concern to the trade policy community, including additional tariff cuts in some sectors (such as fisheries), possibly a new safeguards code, the services trade issue, and agricultural subsidies. On the other hand, there are those who argue that recent experience with the GATT (such as the disappointing outcome of the 1982 ministerial meeting) indicates that further liberalization under the GATT is unlikely.

Canada's trade links are currently heavily dominated by the 70 per cent of its trade which is with the United States. There is a growing recognition of both the non-tariff barriers that apply to U.S.–Canada trade and the difficulty of negotiating reductions in these barriers within a multilateral framework. Some have therefore argued that although Canada should maintain its commitment to the GATT, this commitment should not prevent Canada from pursuing bilateral initiatives, such as discussions of a free trade area, with the United States.

All these themes were discussed during the symposium. In addition, some attempts were made to define the possible contours of a new GATT round and to map out what Canadian interests would be in such a round. The issue of the extent to which Canada has gained from previous GATT negotiations was also explored. On the one hand, as a relatively small country, Canada has gained from the GATT through increased access to larger export markets. On the other hand, because Canada is a net importer of manufactures and most of the trade liberalization in the GATT has been concentrated in manufactured goods, Canada may not have gained as much from the GATT as it would have from a broader ranging approach to trade liberalization. These issues, along with the concern in Canadian trade policy that an overly strong commitment to multilateralism might exclude active bilateral initiatives with major trading partners (such as the United States), provided the main focus of the discussion.



## Historical Review

The General Agreement on Tariffs and Trade is an international trade agreement whose origins lie in the attempt to establish the International Trade Organization (ITO) in 1947. At the time, the GATT was considered an interim agreement that would last until the Havana Charter for the ITO was ratified. The GATT's purpose was to record the results of a tariff-reducing conference held by members of the Preparatory Committee appointed by the Economic and Social Council of the United Nations.

The first round of tariff negotiations was held in Geneva in April 1947, with 23 participating countries.<sup>1</sup> The results of the first round were considered significant in that 45,000 tariff rates were either lowered or bound (with the possibility of subsequent increases limited). When the Truman Administration failed to ratify the charter of the ITO in 1950, the GATT became the main vehicle through which international trade policy was regulated. The GATT was influenced by the Lend-Lease Agreements and the Atlantic Charter, and the main features stressed were world trade on the basis of non-discrimination (the most-favoured-nation (MFN) principle) and national treatment. Other principles were the use of tariffs as the only means of protection for domestic industries (except under carefully defined and controlled circumstances) and the concept of consultation and conciliation to produce negotiations on tariff reductions on the basis of mutual advantage.

The General Agreement was considered a temporary measure that would deal mainly with the lowering and binding of tariffs until the formation of the ITO. The Drafting Committee decided in 1947 that three types of articles would be omitted: those dealing with domestic policy; articles that depended on ratification of the ITO; and articles that would not be implemented immediately. It was intended that the GATT would provide a specific trade agreement within the broader ITO. Some of the provisions included in the Havana Charter, such as those covering employment, international investment, restrictive business practices, international commodity agreements, and a more well-developed institutional framework, were therefore omitted from the GATT.<sup>2</sup>

Six negotiating rounds have been held since the first round: in Annecy, France, in 1949; in Torquay, England, in 1951; in Geneva in 1956; the Dillon Round in 1960; the Kennedy Round in 1964–67, and the Tokyo Round in 1973–79. The GATT today consists of 38 articles and four parts. Part IV, comprising Articles XXXVI–XXXVIII, was added in 1965 to deal with the emergence of the developing countries.

The participating members always intended that the articles of the GATT would be the legal guidelines through which all international trade would be regulated. Disciplinary measures are not instituted automatically if a member country violates a GATT code. Instead, the injured country has the right to withdraw equivalent concessions or take action

recommended by a panel of contracting parties at the injured party's request. The process of consultation and conciliation in the event of a dispute is strongly emphasized.

As of February 1984, there were 89 member countries in the GATT and 30 countries maintaining a de facto application of the GATT rules. Among the most significant non-participants are the Soviet Union, China, Mexico, Venezuela, and most OPEC members.

The most recent Kennedy and Tokyo negotiating rounds have been of particular importance to Canada because of their wide coverage and broad impact on Canada's trade.

### ***The Kennedy Round, 1964–67<sup>3</sup>***

The main event leading to the Kennedy Round was the 1962 U.S. Trade Expansion Act, which gave the U.S. president authority to reduce import duties by a maximum of 50 percent of those existing July 1, 1962. The reductions were to be spread over five years. Four major changes in the negotiations relative to previous rounds were initiated in the Kennedy Round.

- Negotiations took place on a multilateral basis and the concept of general linear tariff reductions was introduced.
- Negotiations on certain non-tariff measures were included. These concentrated on anti-dumping codes and customs valuation (particularly the American selling price).<sup>4</sup>
- Less developed countries were permitted to participate in the negotiations on a less than fully reciprocal basis.
- The United States insisted that negotiations should guarantee acceptable conditions of access for agricultural products to world markets.

The main result of the round was that duties were reduced by an average of 35 percent on 60,000 traded industrial products. Major industrial countries lowered duties on about 70 percent of the value of their dutiable imports in 1964. Tariffs on almost two-thirds of these imports were cut by 50 percent or more. Sectoral negotiations were initiated in aluminum, chemicals, pulp and paper, steel, textiles and agriculture. The Long-Term Arrangement on International Trade in Cotton Textiles was also extended.

### ***The Tokyo Round 1973–79<sup>5</sup>***

In this second of the broad negotiating rounds under the GATT, 99 member and non-member countries participated in negotiations on an across-the-board basis.

The aims of the Tokyo Round, as set out in the September 14, 1973 "Tokyo Declaration," were to expand and liberalize world trade; secure



additional benefits from international trade for developing countries; and reduce or eliminate non-tariff measures or at least reduce or eliminate their trade-restricting or trade-distorting effects and bring such measures under more effective international discipline. Agriculture was to be specially treated in the negotiations.<sup>6</sup>

At the end of the negotiating round, import duties had been reduced by an average of 34 percent by industrialized countries, with cuts to be implemented over an eight-year period ending in 1987. It is expected that the average level of these tariffs will be in the range of 5 to 6 percent for developed countries by 1987. Agreements were also reached on an improved legal framework for the conduct of world trade and on various non-tariff measures, including subsidies and countervailing duties, technical barriers to trade, government procurement, customs valuation, import licensing procedures, and a revision of the 1967 GATT Anti-Dumping Code.

The Agreement on Subsidies and Countervailing Duties ensures for the first time the uniform application of GATT rules on subsidies and countervailing duties by all signatories. Before applying countervailing duties, signatories are required to demonstrate that a domestic industry is suffering material injury caused by subsidized imports from another signatory. The agreement also provides for the notification of subsidies and for more effective consultation procedures. It covers subsidies for industrial and primary products (agricultural, fisheries and forestry).

Discussions also took place on a legal framework for the conduct of world trade. Five issues make up the work program that the Framework Group agreed to.

The first is more favourable treatment for developing countries, leading gradually to their fuller participation in the GATT. The main provisions in this area are proposed modifications to the most-favoured-nation principle (the enabling clause) to allow contracting parties to grant differential and more favourable treatment to developing countries. The second issue covers safeguard action for balance-of-payments purposes. It was agreed that all restrictive import measures for balance-of-payments purposes should be subject to examination procedures under Articles XII and XVIII of the GATT. Third, the improvement and refinement of GATT dispute settlement mechanisms were agreed to, and ways to achieve these changes are under discussion. Fourth, it was agreed that less developed countries may modify or withdraw concessions to achieve development objectives and that details will be discussed in the Framework Group. Finally, export restriction provisions in the GATT are to be reviewed in the broader context of world trade, with particular focus on the trade and financial needs of the developing countries.

An arrangement was also reached regarding bovine meat. This agreement is of a consultative nature aimed at liberalizing trade of bovine

animals. The agreement applies to all bovine animals and covers live animals and meat.

In the government procurement area, an agreement was worked out which applies to any procurement contract with a value of SDR 150,000<sup>7</sup> (about \$195,000 in early 1985) or more, including incidental services. Signatories have agreed to give national treatment to all suppliers and not to discriminate between foreign and domestic suppliers. The agreement covers civilian purchases and does not apply to regional or local entities. Developing countries are not required to grant reciprocity on either products or entities covered and are permitted to grant preferential treatment in regional or international arrangements.

The Customs Valuation Agreement aims at establishing a uniform and neutral system for valuing imports, to stop the use of arbitrary or fictitious customs values. Canada agreed to implement the code by January 1, 1985, provided it could revise tariff rates upward where adoption of the new system would result in a significant decrease in the level of protection afforded to domestic producers under the existing system.

Under the Agreement on Technical Barriers to Trade, signatories agreed to administer their regulations according to international standards, including testing and certification requirements, to minimize unnecessary restrictive effects on imported goods. This agreement, however, applies only to national governments.

The Agreement on Import Licensing Procedures stipulates that licensing rules must be published promptly. Forms and procedures are to be as simple as possible. An applicant who is refused will have the right to explanation and appeal.

Under a separate Agreement on Civil Aircraft, signatories agreed to eliminate all tariffs and equivalent charges applied to the import and repair of these products by January 1, 1980. Covered are civil aircraft, civil aircraft engines, ground flight simulators and all other parts and components whether original, replacement, repair, or conversion equipment. This agreement resulted from negotiations among Canada, the European Community (EC), the United States, Japan and Sweden. Furthermore, the Agreement on Technical Barriers to Trade is to apply to certification requirements and operating and maintenance procedures.

An International Dairy Arrangement was also concluded which was intended to expand and liberalize trade in dairy products without causing undue fluctuations in supply and prices. The products discussed include milk, cream, butter, cheese, curd and casein. Canada did not sign the protocol relating to milk products.

Finally, in the agreement on Article VI of the GATT (anti-dumping), changes were made to bring it into line with the new code on subsidies and countervailing duties. A determination of material injury must be



made and must involve an objective examination of both the volume of dumped goods and their effect on domestic prices and producers.

## **Current Problems with the GATT**

Despite the successful conclusion of the Tokyo Round, it is widely agreed that many trade policy problems still persist. Among these is the issue of non-tariff barriers (NTBs), a range of impediments to trade not covered by tariff regulations. Some of these barriers deliberately restrict trade, while others do so only coincidentally. The General Agreement has been unable to eliminate the use of these trade barriers for a number of reasons. First, NTBs are extremely difficult to monitor and identify, since they are often inseparable from a nation's domestic policies. Second, those NTBs dealt with in the original articles of the GATT — such as valuation, quantitative restrictions, import licensing, and safeguards for balance-of-payments difficulties — were meant to be confined to specific purposes and circumstances and to be used on a temporary basis.

The basic problem with the GATT in its present form is that it was originally intended as a temporary framework through which to record the results of tariff-reducing conferences until the implementation of the broader International Trade Organization. One of the basic principles of the Havana Charter underlying the ITO was that protection of domestic producers against foreign competition was to be provided entirely through tariffs, because tariff barriers would be visible to all parties and thus open to negotiation. In fact, since the GATT was signed, many restrictive trade actions, such as the continued and increasing use of voluntary export restraints and orderly marketing arrangements, have been taken outside the GATT framework.

The dispute settlement procedure is another continuing policy concern. This procedure is contained in Article XXII, under which members are committed to consult bilaterally in the event of a dispute, and in Article XXIII (Nullification and Impairment), under which, in the event bilateral consultations are unsuccessful, the parties concerned can request that an objective panel of fellow contracting parties consider the issue and offer a ruling. If the injured party chooses not to adopt these recommendations, the panel may authorize a retaliatory measure.

This informal procedure worked well in the past, but of late several criticisms have been directed at the procedure. Criticisms include the absence of sound monitoring, compliance, and enforcement methods; the increased use of protective methods not covered in GATT rules; and non-adherence by contracting parties to the panel's recommendations.

A contributing factor to the problem of dispute settlement is the growth in membership in the GATT. As of February 1984, there were 89 member countries and 30 countries applying GATT rules on a *de facto*



basis. The Tokyo Round had 99 participating countries, in contrast to the early negotiating rounds in which fewer than 30 countries participated. The GATT has also become cumbersome — the last round took six years to complete.

A further important problem area is the role of the GATT with respect to the less developed countries (LDCs). The inability of the contracting parties to deal satisfactorily with the problems of the developing world is reflected in the fact that GATT negotiations deal mostly with manufactured products, whereas LDCs principally export primary products. Their exports of textiles and footwear face strict import restrictions by industrialized countries attempting to protect domestic industries.

Although of interest to such countries as Korea, Singapore, and Brazil, further negotiations on trade barriers affecting manufactures are of limited significance to many other LDCs, such as those in Africa, even though concessions are given to them when agreements are implemented on an MFN basis and LDCs are not expected to reciprocate fully. They have to accept the results of negotiations between the developed countries and then apply them to their specific needs, which are entirely different from those of the more industrialized countries. LDCs do not currently have any significant capacity to alter the negotiations effectively in their favour.

LDCs' objections to the results of the Tokyo Round included the following.<sup>8</sup>

- No liberalization of existing quantitative import restrictions or import quotas was achieved, nor were any limitations placed on such measures as voluntary export restraints and orderly marketing arrangements.
- Although it is claimed that the gains from the lower MFN duties, obtained in the Kennedy Round, are more than offset by the loss of margins of preference under the Generalized System of Preferences, many LDCs remain doubtful.
- With respect to the framework agreement, the introduction of the principle of graduation is seen as the leading edge in a process of arbitrarily discriminating among developing countries and depriving them of the preferential access they now enjoy.<sup>9</sup>

Only 68 developing countries participated in the Tokyo Round. Of these, only 38 are contracting parties to the GATT and only 16 had signed the Geneva (1979) Protocol or Supplementary Protocol as of December 1, 1979. As one Third World observer stated, "Many Southern countries originally decided to wait until the ITO Charter was ratified before joining GATT. Some are still waiting."<sup>10</sup>

A further problem area for the GATT is that of state trading. The major difficulties arise when trying to integrate countries with centrally planned economies into the framework of an institution based on the

principle of free enterprise. Problems include the pricing and valuation of exports, potential dumping, MFN status, and reciprocity.

This highlights the problems of integrating state-trading countries into the GATT system. Participating state-trading countries include Poland, Czechoslovakia, Yugoslavia, Cuba, and Romania. A provision dealing with the special problems of state-trading countries was included in the suggested charter of the ITO but was omitted when it became clear that the Soviet Union would not participate in the Havana Conference in 1948. Article XVII, however, requires state-trading enterprises not to discriminate in foreign trade. These rules also apply to state monopolies, such as those maintained by a number of countries for tobacco products. These rules apply to the operations of the Canadian Wheat Board, the Canadian Dairy Commission, and the provincial liquor control boards, among others.

## **Canada's Participation in the GATT**

Canada played an important role in the establishment of the GATT, as a member of the preparatory committee. But an evaluation of Canada's future trade policy options within the multilateral GATT framework must consider what Canada has gained or lost from the GATT over the years.

It is often asserted that Canada was a major gainer from the Kennedy Round. In this round, tariff reductions were implemented on a linear basis for the first time. Canada, however, did not participate in this way, arguing that linear cuts would lead to relatively large reductions on price-sensitive imports of manufactures, while price-insensitive exports would receive only modest duty cuts in absolute terms. Canada's special status was accepted by the other Kennedy Round participants. Canadian tariffs were cut on \$1.4 billion of imports from the United States, almost half of them by more than 25 percent. The United States in turn cut tariffs on \$1.25 billion of imports from Canada. Canada accepted the revised anti-dumping code, which had differed in the past from the standards laid down in the General Agreement.<sup>11</sup>

In the Tokyo Round, Canada took part in the negotiations on the same basis as the rest of the participants. The Canadian delegation favoured sectoral negotiations as the best way to reduce tariff and non-tariff measures, although the broader formula approach prevailed. The result was an average weighted tariff cut of close to 40 percent on Canadian exports to the United States, the European Community, and Japan taken together. The average reduction in Canadian tariffs is comparable. By 1987, when the agreement will be fully implemented, well over 90 percent of current Canadian exports will enter the United States at tariffs of 5 percent or less, and after taking into account trade under the Auto Pact, a significant percentage of exports will be duty free. In the case of Canadian tariffs, the average rate on dutiable industrial imports will be



reduced to between 9 and 10 percent. Most industrial raw material imports will continue to be free of duty, although Canada made relatively small or no reductions in the level of Canadian tariffs on textiles, footwear, clothing and ships.

On the agricultural side, concessions covering over \$1 billion worth of Canadian exports were exchanged with Canada's major trading partners. Improved access was obtained for Canadian whiskey in the United States, the European Community and Japanese markets. Canada obtained a concession from the EC on exports of aged cheddar cheese and after the negotiations it obtained a share of a substantial tariff quota for high-quality beef with the EC as a result of the Tokyo Round.

In evaluations of Canada's position toward the GATT, it is still widely felt that Canada has more to gain from further multilateral negotiations. The basis for this argument is that Canada can use its influence with the small and middle-sized countries to combine as necessary against the major trading powers. A related consideration in evaluating Canada's performance in the GATT is the lack of negotiating leverage Canada would have as a smaller country against larger countries.

## **The Possible Agenda for a Future GATT Round**

Upon conclusion of the November 1982 GATT ministerial meeting, it was agreed to undertake a work program for the 1980s. The contents of this program and the unfinished business from the Tokyo Round are generally expected to make up the agenda of a possible future GATT round.<sup>12</sup>

**Safeguards**      The issue of safeguards, left over from the last round of negotiations, is of primary concern. According to the paper presented by Weekes, improvement of the safeguards system is the single most important trade policy issue confronting the GATT for a number of member countries. However, despite broad acknowledgment of the need for such an agreement and the shared conviction that any new arrangement should clarify the provisions of Article XIX and place all measures with a safeguards effect under international discipline, it is not clear that a new agreement is readily negotiable.

**Government procurement**      This issue is of great significance to Canada because there are a number of sectors where Canadian industry is internationally competitive but government procurement practices abroad effectively close some foreign markets. Telecommunications, power generation and transmission, and surface transportation equipment are all examples. Even though some agreement on the procurement issue was reached during the Tokyo Round, it is expected that signatories to the code can make more progress in a future round.



**Subsidies and countervailing duties** The Subsidies and Countervailing Duties Code is also the subject of continued discussion and future possible negotiation, based on experience gained since the Tokyo Round. Of particular concern is the increased use of subsidies in the agricultural sector, coupled with the need to examine the risk of a new form of protectionism posed by the use of subsidies. Conflicting with this concern is the recognition that subsidies are important tools for achieving social and economic objectives.

**Services** A new issue of growing importance, to be dealt with in a future round, is trade in services. At present, no framework of rules provides international discipline on trade in services on a basis similar to the discipline covering trade in goods provided by GATT. Work is now underway in both the Organization for Economic Cooperation and Development (OECD) and the GATT to improve understanding of this issue.

**Agriculture** A Committee on Trade in Agriculture was established as part of the GATT Work Program. To date, participants have examined country notifications of measures affecting trade in agricultural products and have begun discussions on the question of subsidies. The close relationship between domestic agricultural policies and border measures has meant that relatively less progress has been made in liberalizing trade in agricultural than in industrial products, particularly with respect to non-tariff barriers. From a Canadian perspective, greater discipline for agricultural trade under the GATT is an important objective and one that will not be easily achieved.

**Natural resource products** The GATT Work Program provides for specific attention to the preparation of studies and recommendations on tariff escalation and to the access provided for resource-based products. Sectors being studied include fisheries, non-ferrous metals, and forest products. Canada successfully pressed for the inclusion of fisheries in the work program, the desired result being improved multilateral discipline and lower tariffs and non-tariff barriers (NTBs). The results of the Tokyo Round in the fisheries sector were disappointing for Canada, as a number of fisheries products continue to face high tariffs and a range of NTBs, especially in the European Community. Canada would also like to pursue ways of improving access for Canadian petrochemical products in foreign markets.

**Quantitative restrictions and non-tariff measures** Quantitative restrictions and other non-tariff measures continue to be a source of contention affecting the working of the international trading system. The GATT 1982 ministerial declaration established a group with the mandate

to review these two areas to achieve the elimination of quantitative restrictions that do not conform to GATT rules and to achieve the liberalization of other quantitative restrictions and non-tariff measures.

**High technology** The subject of trade in high technology products has recently received considerable attention, especially from the United States. Even though this issue was not included in the GATT ministerial declaration, the United States has been trying to initiate a work program on trade in high technology products. The subject remains on the agenda for future GATT discussions.

**Developing countries** Canada and many other developed countries have expressed an interest in seeing developing countries participate more fully in the GATT. The 1982 ministerial meeting mandated the inclusion in the work program of a number of issues of particular interest to developing countries, including improved access for tropical products, liberalization of trade in textiles and clothing, structural adjustment, and strengthening of the implementation of Part IV of the GATT.

**Dispute settlement** The GATT dispute settlement procedure has been the object of much criticism and is expected to be an important topic of discussion in a future round. Despite the strengthening of procedures to some extent during the Tokyo Round, considerable concern remains about the effectiveness of the process. These concerns include the composition of panels, the provision of legal advice by the GATT Secretariat, the degree of emphasis on conciliation as opposed to adjudication, the handling of poor or disputed panel findings, and the commitment of contracting parties to take action in response to unfavourable findings and recommendations. It has been a Canadian objective to see a strengthening of these procedures through the increased use of panels of independent experts.

**Counterfeit goods and investment measures** Further areas that the United States has indicated interest in and that have the potential of being on the future agenda include trade in counterfeit goods and trade-related investment measures.

The United States has developed a draft code on commercial counterfeiting. Despite the rejection of the U.S. proposal for work at the ministerial meeting on investigating the incidence and impact of trade-related investment measures, this issue continues to be of interest to the United States and is thus a potential topic in a future negotiating round.



## Canada's Future Trade Policy Initiatives in Light of the GATT

Given the difficulties that the GATT framework for regulating world trade is currently encountering and the set of Canadian interests in global trade, part of the symposium dealt with the implications of developments within the GATT for Canada's future trade policies.

In essence, three different options were explored. The first was based on the perception that the GATT had been somewhat weakened through the difficulties encountered in the 1970s, but that as a major gainer from the global multilateral framework, it should pursue a more active role in re-invigorating multilateralism. This option would involve Canada's conscious avoidance of any actions that would fragment the GATT. Canada would become an active participant in a new GATT round and would seek to promote and preserve existing multilateralism.

The argument underlying this position seemed to be that even if there are difficulties in negotiating a new GATT round, the most important consideration in Canadian trade policy should be at least to preserve the benefits obtained thus far from the GATT. Although the rules and codes of conduct manifest in GATT agreements have deficiencies, these rules and codes nonetheless represent the rule of law in international trade. It was argued that as one of the smaller countries in the global trading system, Canada has a lot to gain from the preservation of these arrangements. Any action on Canada's part that would weaken multilateralism is therefore to be avoided.

The second option outlined was for Canada to continue to participate in the GATT but also to pursue other options. The issue of how much influence Canada can realistically have over future GATT negotiations was raised. In the past, Canada has tended to be only a participant, not an initiator. Because of Canada's relatively small size compared to the United States, Japan, and the European Community, it has not had a major influence on the broad direction of GATT negotiations. However, some participants argued that even though this was the case, the issues that concern Canada are often matters of detail rather than of broad posture and that Canada has successfully managed to achieve many of its objectives. The contrary argument was that because of the multilateral framework in the GATT, Canada is in effect put in the position of negotiating its arrangements with its largest trading partner, the United States, through a complex and at times clumsy multilateral framework when many of these issues might be more appropriately taken up bilaterally. Some argued further that Canada should not refrain from moving toward bilateral negotiations with the United States because of fears of a possible weakening or fragmentation of the GATT. Although Canada should maintain its commitment to the multilateral framework, other countries have moved toward regional trading blocs (such as the EC, the



Caribbean Basin Initiative, and the European Free Trade Association) and Canada should do the same.

The third option discussed focussed on the issue of whether or not the GATT itself has reached an impasse as an institutional framework from which it is difficult to advance. Over the years, there have been many suggestions for alternative regional groupings in global trade arrangements along the lines of a multi-tiered GATT system. Under such an arrangement, codes would be drawn up for such matters as subsidies or government procurement, creating a network of new rights and obligations among the countries that accept them. This super-GATT might involve a smaller group of countries more actively interested in trade liberalization issues and perhaps willing to accept proposals made by other countries. This group could consist of five to ten countries, and if the perception was that Canada could gain from such an arrangement, it might play an active role in promoting the concept. Such a group of countries might take initiatives on issues that go beyond narrow trade liberalization questions themselves. One possibility raised was for some initiative for a joint agreement on domestic sterilization policies in the event of a major default on outstanding foreign debt by the less developed countries.

It was agreed that whatever option is pursued, designing Canada's future trade policies will involve a judgment both of the desirability of preserving the present global trading system and of the possibilities for negotiating new arrangements advantageous to Canada. The feeling was that unlike many other issues in economic policy, this issue is not one on which a clear argument can be advanced that one policy option will automatically dominate the other. However, if there was a consensus in the symposium, it veered in favour of more active consideration of possible bilateral arrangements with the United States, along with statements of a strong commitment to the preservation of existing GATT obligations.

## **Summary of the Symposium Papers**

The symposium paper presented by John Weekes dealt mainly with the contents of the GATT Work Program and the topics for consideration in a future round of negotiations, from a Canadian perspective.

Weekes affirmed the view that the multilateral system is the best way of advancing Canadian interests internationally and that the GATT is at the heart of this system. He noted that Canada's main trading partners are generally much larger than Canada but that as a member of the GATT, Canada can align itself with others to obtain concessions and protect the integrity of what is being negotiated. Weekes referred to the 1983 trade policy review published by the Department of External Affairs in highlighting two key points — that trade is crucial to Canada's

economic well-being and that the relationship between competitiveness and trade performance is important. He also noted the government's responsibility along with the private sector for a competitive environment.

Frank Stone's paper reviewed the general role and structure of the GATT as the central element in the broader multilateral trading system. He emphasized that the GATT represents Canada's main trade agreement with most of its trade partners, including the United States. Stone reinforced the view that as a middle-sized country whose main trade partners are large countries, Canada has benefited substantially from the GATT system. He also pointed to the fact that close to 80 percent of Canada's exports to the United States will be duty-free by 1987 and that 65 percent of Canada's current imports from the United States will be duty-free by then. It was acknowledged, however, that trade liberalization under the GATT has been uneven and in some sectors, such as agriculture, has been incomplete. Stone discussed the possibilities for strengthening such GATT-related functions as continued consultation between trading partners, dispute resolution, information gathering, and research and analysis. These he viewed as functions that are important but are often overlooked.

Looking at recent developments, Stone acknowledged the severe strains that have developed in the multilateral trading system and the difficulties encountered at the November 1982 ministerial meeting. Increased speculation about a new round of negotiations and increased support for bilateral initiatives with the United States led Stone to stress the need for Canada to avoid bilateral arrangements that would damage the multilateral system. He also emphasized that Canada should support any initiatives to strengthen the GATT.

The written observations of Jan Tumlrir on the present state of the international trading system and Canada's participation in it were distributed at the symposium. In Tumlrir's view, the tariff-cutting rounds of negotiations have been a secondary activity in the GATT. The GATT's main function is to maintain stability in the global economy. This stability has been achieved through the binding of tariffs and the suppression of quantitative restrictions, but the GATT's failure to deal effectively with quantitative restrictions was readily admitted.

In evaluating how Canada has fared in past negotiations, Tumlrir stated that it was pointless to compare the benefits individual countries have derived from the GATT system. Until the end of the 1960s, Canada fared as well in the system as other members. In the 1970s, the discipline of the system eroded — Canada contributing its share, if not more, to this erosion — and the Canadian economy suffered just as others did.

Addressing the question of a possible future round of negotiations, Tumlrir was pessimistic at best. In his view, practical solutions that can



command political agreement have yet to be devised. This view implies that there is nothing as yet that could be usefully negotiated.

On a general level, Tumlr emphasized the need for creative commercial diplomacy and the need to recognize the problems that the increased size of the system has created for communicating trade interests between countries.

## **Summary of the Symposium Discussion**

The panel members fielded a broad range of questions during the symposium, but discussion centred on the issues of the bilateral and multilateral approaches in Canadian trade policy, the prospects for a future negotiating round, the trade issues affecting the GATT and developing countries, and the role of the GATT in structural adjustment issues.

### ***The Bilateral and Multilateral Approaches to Canadian Trade Policy***

The balance between a bilateral and a multilateral approach to Canada's trade policies was considered to be at the heart of the debate on the GATT and Canadian interests. Panel members were asked whether they saw the GATT as the primary forum by which trade policy, legal procedures and institutional changes affecting the global trading system could be developed or whether the primary forum would be much smaller groups of countries. A second question concerned the implications of bilateral arrangements for the multilateral framework and the issue of whether the substantive results of bilateral negotiations could be multilateralized at some point. A further question was what Canada, as a middle-sized industrialized nation, would gain in the long term from operating outside the multilateral framework. Another was whether we are moving toward some kind of interregional negotiations at the international level, involving negotiations between blocs of countries. A final comment for consideration by the panel was that since 70 percent of Canada's trade is with the United States and the GATT has become so large, the GATT may be an inefficient and clumsy way for Canada to negotiate its trade interests.

The consensus among panel members was that the GATT and the multilateral system would continue to be at the centre of the international trading system in the years ahead. It was stressed that there is no absolute choice between a bilateral and a multilateral approach, since a purely bilateral trade system is inherently unstable. It was also pointed out that the GATT does not preclude a bilateral approach. On the contrary, issues are dealt with bilaterally and then extended on a most-favoured-nation basis. The cumbersome nature of the MFN principle was acknowledged, but it was emphasized that it provides the basic stability for the world trading system.



One panelist suggested that it is only natural that fundamental questions concerning the GATT should now be raised, because the world economic environment has changed since the inception of the GATT. In addition, he suggested that the MFN basis within the GATT has been declining over time in a consistent way and that many issues are dealt with on a less-than-MFN basis. The view was expressed that those countries with similar interests, whether favouring more liberalization or less, should negotiate together — possibly implying a move to a two-tier form of negotiation within the GATT. Finally, one participant commented that nobody wants a purely bilateral approach to trade policy, especially if the effect of such initiatives would be to weaken or destroy the multilateral system. He pointed out, however, that since British entry into the European Community did not destroy multilateralism, even with British participation in the Common Agricultural Policy, limited bilateralism in Canada's trade policies should not do so either.

### *Prospects for a Future Negotiating Round*

Another topic that generated considerable discussion was the prospect of a future negotiating round. The panel was asked to comment on the chances of a new round in the late 1980s and on the contents of a future agenda.

The growing interest in a new round of multilateral negotiations, especially on the part of Japan, was generally acknowledged among panel members. Statements made at the Williamsburg Summit Conference and during other high-level exchanges were seen as confirming this speculation. It was reported that the Japanese delegation at the latest annual GATT meeting suggested that thought be given to preparing a new round of negotiations to boost confidence in the world economy and ensure economic recovery. However, one panelist suggested that since the GATT Work Program is barely half finished, it seemed premature to be looking for any decisions at this early stage.

Other panel members suggested that the content of the GATT Work Program might be the basis of the agenda for a future round. Another participant suggested that non-GATT issues, such as restrictive business practices and cartels, should be included.

### *The GATT and the Developing Countries*

The panel were asked to elaborate on efforts to integrate developing countries into the GATT system and to make them feel they can prosper along with the developed world in a global trading system run under GATT rules. Canada's efforts in particular were not addressed by panel members. One panelist explained that the GATT was not written for the less developed countries and that there is much reluctance by the LDCs

to join fully, despite efforts to accommodate them in the GATT through such programs as the Generalized System of Preferences and the framework agreement. It was suggested that a North-South negotiation could bring the developing countries and the newly industrializing countries more fully into the GATT system and provide them with benefits from their participation.

### *Structural Adjustment Issues*

When asked to comment on the direction the GATT might take on structural adjustment, one panelist responded by pointing out that very few provisions in the GATT deal with structural adjustment. Furthermore, it has been difficult to come to grips with this issue because of the tension it has created between what is best for the international system and what is best for the country making the structural adjustment. The panelist viewed this problem as one of the major weaknesses of the GATT, and one that will have to be addressed if trade policy conflicts in steel, textiles, and footwear are ever to be resolved. Another panel member added that it had been left up to each individual country to decide how to accommodate or manage its internal structural adjustments. The diversity of interpretations of what structural adjustment means was also noted.

Although the international trading system has come under increasing strain in recent years, there was general support among the participants for the multilateral system. Alternatives such as a super-GATT or a North-South negotiating round were discussed as methods of addressing the challenges that now threaten the process of trade liberalization under the GATT, rather than as successors to the GATT. It was also widely acknowledged that interest is growing in a new round of negotiations in the late 1980s. However, what the future agenda will contain and what form the negotiations will take remains speculation at this stage.

Despite efforts that include the preferential treatment accorded under the Generalized System of Preferences and the framework agreement, the difficulties of integrating the developing countries into the GATT system and their reluctance to join fully were emphasized. Finally, the panel members recognized the complicated issue of structural adjustment as a weakness of the GATT that must be addressed in future if the GATT framework for regulating trade policies around the globe is to be advanced.



## Notes

We are grateful to several of the symposium participants and particularly to John Weekes of the Department of External Affairs for helpful comments on an earlier draft.

1. The 23 participating members at Geneva in April 1947 were Australia, Belgium, Brazil, Burma, Canada, Ceylon, Chile, Cuba, Czechoslovakia, France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, South Africa, Southern Rhodesia, Syria, United Kingdom, United States.
2. The information in this paragraph is drawn from John H. Jackson, *World Trade and the Law of GATT* (Indianapolis: Bobbs-Merill, 1969), p. 43.
3. This section draws on Fred Lazar, *The New Protectionism: Non-Tariff Barriers and their Effects on Canada* (Toronto: James Lorimer for the Canadian Institute for Economic Policy, 1981), pp. 2–3.
4. The American selling price system uses national values higher than the market price in calculating tariffs of certain products.
5. This section is based on Lazar, *The New Protectionism*, pp. 8, 83–87; Frank Stone, *Canada in the General Agreement on Tariffs and Trade* (Ottawa: Institute for Research on Public Policy), 1984; and GATT–Multilateral Trade Negotiations (Tokyo Round), April 1979 (background notes summarizing the results of the negotiations).
6. See Sidney Golt, *The GATT Negotiations, 1973–1975: A Guide to the Issues* (Toronto: C.D. Howe Institute for the British/North America Committee, 1974), p. 57.
7. SDRs are Special Drawing Rights in the International Monetary Fund, used by the IMF and many countries as a unit of account.
8. Isaiah Frank, *Trade Policy Issues of Interest to the Third World* (London: Trade Policy Research Centre, 1981), pp. 16–17.
9. The framework agreement established the legal basis for special and preferential treatment for developing countries. The industrialized countries insisted on the principle of graduation, which meant that the special treatment granted to the developing countries would be gradually withdrawn as warranted by their economic progress and that they would be expected to more fully participate in the GATT.
10. Margaret A. Biggs, *Canada and Third World Trade* (Ottawa: North-South Institute, 1980), p. 69.
11. Ernest H. Pegg, *Traders and Diplomats* (Washington: The Brookings Institution, 1970), pp. 187–88.
12. This information is based on the paper “Issues for GATT in the 1980s,” presented by John Weekes, Department of External Affairs, for the research symposium on the GATT and Non-tariff Barriers to Trade, December 2, 1983, Ottawa.

## Appendix

### List of Participants

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#### RESEARCH SYMPOSIUM ON THE GATT AND CANADIAN INTERESTS HELD BY THE ROYAL COMMISSION ON THE ECONOMIC UNION AND DEVELOPMENT PROSPECTS FOR CANADA

Ottawa, December 2, 1983

Margaret Biggs	North-South Institute, Ottawa
Keith Christie	Department of External Affairs, Ottawa
Peter Cornell	Economic Council of Canada, Ottawa
John Curtis	Institute for Research on Public Policy, Ottawa
Gerald Helleiner	University of Toronto, Toronto
John Higginbotham	Department of External Affairs, Ottawa
James Hyndman	Department of Regional Industrial Expansion, Ottawa
James Markusen	University of Western Ontario, London
Peter Morici	National Planning Association, Washington, D.C.
Andrew Moroz	Institute for Research on Public Policy, Ottawa
W. Douglas Newkirk	Office of the United States Trade Representative, Washington
John Quinn	Osgoode Hall Law School, Toronto
Edward Safarian	University of Toronto, Toronto
Gerry Salembier	Institute for Research on Public Policy, Ottawa
Ronald Shearer	University of British Columbia, Vancouver
Frank Stone	Institute for Research on Public Policy, Ottawa
Rodrigue Tremblay	University of Montreal, Montreal
John Weekes	Department of External Affairs, Ottawa
John Whalley	University of Western Ontario, London, and the Royal Commission
Bruce Wilkinson	University of Alberta, Edmonton
Peter Williams	GATT Secretariat, Geneva
Gilbert Winham	Dalhousie University, Halifax, and the Royal Commission
Ronald Wonnacott	University of Western Ontario, London

#### From the Royal Commission

Ivan Bernier  
Douglas Green  
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## The Services Industries: A Note of Caution about the Proposal to Negotiate General Rules about Traded Services

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This memorandum comments on the proposal that general rules regarding traded services should be one of the subjects of a further round of multilateral negotiations, most probably under the auspices of the General Agreement on Tariffs and Trade (GATT).

The extent of services as an economic activity in Canada has been examined by the federal government's Task Force on Trade in Services, which made its final report in 1982. This report was drawn upon for the national study which, at the 1982 meeting of the GATT ministers, Canada agreed to carry out.<sup>1</sup> The U.S. and British studies,<sup>2</sup> along with Japanese, Dutch, Finnish, Swedish and EEC studies for the GATT, have been completed and made generally available. This paper does not propose to review these submissions or to dwell on the statistics, such as they are.<sup>3</sup> Nor does it try in great detail to prove the obvious: that Canada, like other advanced industrial countries, and indeed like many developing countries, has become a "services" economy, both in terms of production and in terms of employment.<sup>4</sup>

However, services are traded by Canada and into Canada much less than are goods. This is merely one way of saying that many services are provided in essentially domestic markets (e.g., personal care, broadcasting, railway transportation) and that foreign participation in such services sectors is often by way of investment in service facilities rather than trade. What is confusing about the meagre statistical framework is the tendency to talk of services as being identical with the broader category of "invisibles," and thus to include in the services aggregates those transactions which represent the return on capital — i.e., interest and dividends.<sup>5</sup> Discussion of the services sector should, of course,

include such items as underwriting and brokerage fees, which are payments for services.

The discussion internationally is of course about traded services such as data processing, air transport, insurance, re-insurance, and the related issues of restrictions on foreign direct investment in establishments to deliver services, but not about capital flows in general and the rent of capital.

## **The Proposal**

The proposal to negotiate some set of comprehensive international rules covering trade in services is based on the perception that there are restrictions on such trade, that such restrictions could be eliminated or brought within a framework of rules and a system of dispute-settlement by negotiating rules of an across-the-board character, rather than by negotiating sector by sector. Clearly, this is an approach which must have some appeal to the United States, and perhaps to some member-states of the EEC (obviously to Britain), because they are competitive providers of a range of services to other countries. It is likely to have very little or no appeal to developing countries, many of which wish to develop all or at least some of their own services industries and to control access to their domestic services markets by foreign firms, and which therefore will not wish to be pressed to take part in a general negotiation. In any across-the-board negotiation they may find it difficult to identify the implications of proposed rules for particular service sectors. If they do identify the implications, they may not wish to accept rules that would limit their existing rights to restrict access to their services markets.

In evaluating this proposal, we should start from the recognition that services trade is not conducted in a vacuum with no rules. There are, in fact, important bilateral and multilateral understandings, negotiated laboriously and over long periods of time, about transactions in regard to various traded services, or certain aspects of such transactions — such as transport by air and by sea, banking, communications, and insurance. Moreover, economic agents engaged in trading services do so with knowledge not only of the various explicit and detailed international arrangements but also of the various systems of national regulation which can affect their transactions, as well, of course, as knowledge of the extensive body of acceptable commercial practice and of relevant private international law.

Certainly there are problems now arising, and others likely to emerge, in regard to traded services and the activities of foreign-controlled corporations in the services sector. For example, three recent controversies between Canada and the United States concerned the services category. One is the so-called “border broadcasting” issue. Another is



the problem raised by Canadian trucking firms operating in the United States. A third is the provision in the Bank Act which imposes a requirement on foreign-controlled banks in Canada to maintain certain records within Canada. Many American banks find this objectionable because they think it has little to do with regulating banks and much to do with protecting Canadian data-processing facilities. It is noteworthy that these examples all relate to regulated industries; many services industries are in fact regulated, and regulation can easily be a cover for protection. Some difficulties between Canada and the United States arise merely because of differences in regulatory patterns and changes in the scope of regulation or “deregulation.”

The issue being raised is whether it is better to negotiate such issues, which are probably increasing in importance and number, on a one-by-one, sector-by-sector basis, or whether they would be more manageable if addressed within some general framework of rules negotiated multilaterally — that is, to put it bluntly, worked out primarily between the EEC and the United States. An obvious alternative for Canada is to work out a bilateral accommodation with the United States on each of the more important services sectors, such as banking, trucking, broadcasting and data-processing, and to deal with other countries as issues arise. Doing so would help meet the sensible objective of preventing discrimination against Canadian exports and offering a reasonable measure of reciprocity in the sector at issue. That is what Canada has been doing in regard to banking, for example.

The U.S. study referred to above, which emerged in the closing days of 1983, makes perhaps the most moderately stated and comprehensive case for negotiating somewhere some rules about traded services. It makes a cautious case for extending certain of the GATT concepts to services — that is, from the point of view of U.S. services corporations. However, it does not examine in great detail the implications for developing countries. It lays some emphasis on the concept of “national treatment.” Article III of the GATT sets out the “national treatment” obligation. It provides that once the fee charged or barrier imposed at the frontier in relation to imported goods has been surmounted, the imported product must then be treated on the same basis as a domestic product. This is important for such matters as taxes on commodities, such as the Canadian sales taxes. To U.S. spokesmen, this has seemed to be a useful model for the traded services sector.

Given that the United States has elected to pursue the issue of rules for traded services primarily within the GATT — and not primarily in the Organization for Economic Cooperation and Development nor at all in the United Nations Conference for Trade and Development — it would be useful to consider the applicability of at least the key GATT concepts to traded services. This paper is, accordingly, in the main a discussion of

how GATT concepts and practices, as well as practices sanctioned by the GATT, might fit in regard to traded services.

The tentative conclusions of this paper can be summarized more or less as follows. First, the GATT, as a set of rules and as a system, is in considerable disarray. It is not working effectively for traded goods. We should ask, therefore, whether it is prudent to assume that it could be even an analogue for rules for traded services.

Second, a number of key provisions — Articles VI, XII and XIX, for example — have evolved as rules to *limit* the use of existing trade agreement provisions or existing domestic legislation which permitted restrictions on imports. If transposed to traded services, these GATT rules would in effect sanction the taking of restrictive action of kinds not now commonly found in the services area, including anti-dumping and anti-subsidization duties, measures to protect the balance of payments, and safeguard or “escape clause” measures to protect particular producers. This would be, on balance, a retrograde step. However, this does not mean that such an approach is not part of the agenda, even if, as is usual, the agenda is partially hidden.

Third, broad general rules of a horizontal or across-the-board character, such as might be negotiated by the EEC and the United States and then imposed on other countries such as Canada in a multilateral negotiation, are not likely to take much account of Canadian interests, the interests of other small countries, and certainly not the interests of developing countries.

Fourth, while there may well be costly restrictions on traded services, there are other restrictions on trade, and other trade policy issues, which are perhaps of even greater importance, even to the United States. These include restrictions with respect to agriculture, textiles and clothing, steel and automobiles, as well as the question of improving the terms of access for exports of developing countries. Focussing on the issues that arise in regard to traded services, important as they may be to U.S. service companies, diverts attention from those other difficult trade issues which threaten to destroy what little is left of the postwar system of trade relations.

Those are the conclusions. Let us look in more detail at the question of whether we should direct our trade policy efforts to negotiating general, GATT-derived rules about traded services.

## What Interests?

It would be useful, before we go very far, to try to identify just what specialized interests will be advanced. Once those interests are identified, the obvious question to ask is whether those interests, if legitimate, can be served by some more economical or more limited approach — economical in not drawing so heavily on the national credit in the



conduct of relations with other countries, and more limited in the sense that other countries may view more narrowly defined objectives as having a less adverse effect on their interests.

There appear to be various services industry groups in the United States which are of the view that their attempts to sell their services outside the United States are being unreasonably limited by foreign government actions and that the one way to bring these actions under control is through such multilateral negotiations as will ensure that the restrictions and prospects of a number of services industries and a number of goods-producing industries are considered at the same negotiating table at the same time.

The two industries particularly concerned are insurance companies (primarily non-life) and consumer credit and financial institutions. Insurers wish to sell various types of insurance in a number of markets outside the United States and have found that governments of other countries sometimes regulate their domestic insurance markets so as to favour national enterprises (or merely the friends of the government) and to discriminate against foreign suppliers. Consumer credit and financial services institutions rely on cross border transmission of credit data and transaction information to offer a competitive consumer credit and consumer banking package. Representatives of these industries have been active in the discussion of “services” and have vigorously argued for the multilateral, multisectoral negotiations approach as offering the best solution to their problems.

However, it has not been established — certainly not by the U.S. study — that the interests of these particular U.S. private sector entities could not be as well served by some more limited bilateral efforts. It may be that the negotiating credit of the United States in the trade relations segment of foreign policy might be better used in more conventional trade policy areas such as agriculture, textiles, steel, and autos. To put the question another way, it may not be prudent to try to build a radically innovative trade policy, which is bound to be a complicated structure, on the interest of only a few corporations. A much broader base of perceived need and a broader working consensus, national and international, are necessary. Before getting into negotiations, we need to reach that consensus and be certain that we can master the will to carry the negotiations through. There is little evidence of any understanding of these imperatives in the U.S. administration or the Congress, and extraordinarily little evidence of a concern for the way other smaller countries perceive these issues.

## **Gains from Trade**

Some of the initial attraction of the “services proposal” formulated in Washington is due to the notion that the economic logic that informs the

case for freer trade can and should be extended from traded goods to traded services. Surely, it is suggested, the logic of comparative advantage and of the gains from trade must apply to transactions in intangibles as well as tangibles. This is one of the key working assumptions in the discussion about traded services. However, even if we agree with this assumption, it leaves a lot of questions still to answer in regard to services and, of course, in regard to goods. The key questions are: How important are the gains from trade in particular services sectors? How important are these gains in relation to others, such as gains in the maintenance of national identity (sovereignty) or the protection or building up of domestic capacity in various services sectors? These are the questions that many smaller countries, and many developing countries, are trying to address — and they are doing so, as they must, on a sectoral basis.

## **The Trade Relations System**

A different way of coming to grips with the proposition that we should somehow extend to traded services the system of rights and obligations developed in relation to traded goods — or, to state the proposition more carefully, that we should address the problems raised by restrictions on traded services by developing an analogous set of general rules — is to consider the trade relations system as it exists. Do we have a system which could be extended to traded services or could be an analogue for a set of general rules for traded services?

The complex of trade policy rules can be viewed as a loose system with a number of subsystems or, in some contexts, contradictory systems. At the centre of the trade relation system is a generalized, multilateralized trade agreement — the GATT. This agreement is derived from the provisions, indeed the detailed language, of the prewar regime of commercial treaties drawn up as bilateral arrangements but linked by provisions granting unconditional most-favoured-nation (MFN) treatment.<sup>6</sup> This commercial-treaty language and structure developed over several centuries.

The central issue in trade policy as it developed in relation to goods and to shipping was the conflict between the concept of bilateral reciprocity (and the closely related concept of conditional MFN treatment) and the concept of non-discrimination, as embodied in the MFN clause in the unconditional form. These concepts have reappeared in the debate on services.

The key issue in the “system of treaties” was whether or not concessions (most importantly, reductions in tariffs and in charges on shipping) negotiated with one trading partner were required to be extended automatically, that is, without additional payment, to other nations with MFN treaty rights, or whether a concession paid for by one country



should be extended to goods or ships from another country only when that other country made a comparable payment. The United States based its trade policy on this so-called conditional MFN treatment until 1924–25. After that period the emphasis in U.S. trade policy shifted to trying to prevent discrimination against U.S. exports, rather than protecting the U.S. manufacturer in his domestic market. European countries wavered between one approach and the other. Britain adopted the unconditional approach in the 1860s in the negotiation of the commercial treaty with France, but after World War I there was a significant reversion in Europe to concepts of bilateral reciprocity and bilateral bargaining.

The pros and cons of bilateral reciprocity have, in fact, been exhaustively argued in relation to traded goods. By the mid-1920s it became abundantly clear that whatever could be said — and that is quite a lot — for the notion of reciprocity cast in broad, general terms, as invoked by Cordell Hull in his Reciprocal Trade Agreements Program, the notion of precise reciprocity in product terms, in relation to traded goods, is unworkable. However, when applied to certain services, particularly those services provided by extensively regulated industries and those involving direct investment and establishment, the notion of reciprocity, when carefully formulated, has proved workable and useful, as Canada's policy with regard to foreign-controlled banks in Canada may show.

## **The Key Concepts of the GATT**

As drafted in what was only the commercial policy chapter of the Havana Charter, the GATT rested on a number of concepts — all of which remain intellectually valid and all of which are being extensively ignored.

The key concept, as already noted, is non-discrimination. This was set out in Article I, an MFN clause cast in the unconditional form. Concessions negotiated with one GATT signatory must be extended unconditionally — that is, without other specific payment — to all other GATT signatories. However, the United States applies certain arrangements negotiated in the Tokyo Round on the basis of reciprocity, or the conditional MFN clause. This is very likely to be the pattern followed for services agreements, and here there would therefore be a major departure from the GATT model.

A second principle, which was a key element in the postwar bargain, was that there should be no new preferences. This was putting a ceiling on discrimination. Existing margins of tariff preferences were not required to be abolished; the absolute margins could be maintained but not increased, and it was assumed that all countries giving tariff preferences would be prepared to negotiate reductions in preferences. It is common knowledge that these provisions have been widely flouted;

preferences and discrimination in one form or another are what modern trade policy is largely about. It is therefore quite likely that if general rules are developed for traded services, preferential arrangements will also be developed for services, in a fashion analogous to the present widespread systems of preferences for traded goods. This may not be in the interest of the United States or Canada because these arrangements, like many existing preferences on goods, will be against North America. Of course, to the extent that the EEC becomes a common market for services, there will inevitably be European preferences against North American services competing in Europe.

Another central concept of the GATT is that trade should be regulated primarily by prices and that accordingly the proper technique for government intervention is a tariff, not a quantitative limitation on imports. The GATT envisages that quotas are to be used only in limited and defined circumstances in the competition between imports and domestic production. However, quotas have not gone away. Quite the contrary. Regimes of administered or managed trade involving controls on imports on the basis of quantities have proliferated since the inception of the GATT, especially in textiles, garments, agriculture, steel, autos and electronic entertainment equipment. Significant sectors of international trade in goods are now either "managed" by governments through the use of quantitative mechanisms, or are controlled by understandings about quantities to be traded which are negotiated between representatives of industries and tacitly accepted by government.

Another GATT concept, and one frequently invoked by representatives of the services sector, is national treatment. Article III of the GATT provides that after the tariff is levied at the frontier, imported goods are to be treated on the same basis as domestic goods within the national market. This is a different concept of national treatment than that developed in the OECD, where the concept refers to the treatment accorded to establishments.

There is one important exception to the GATT national treatment provision — procurement by a government of goods for the use of that government. (Article III is silent, of course, on the procurement of services.) The Tokyo Round Procurement Code, which was devised to provide some rules for this exception in Article III, is now open for renegotiation, as required by subparagraph IX, 6(b) of the Code. The United States, it is understood, is proposing that this agreement be extended to the procurement of services, which are now covered only if they are incidental to a contract for goods. Such proposals are likely to be very contentious. In Canada, for example, even Canadian subsidiaries of foreign consulting firms have generally been denied the right to compete for certain consulting engineering contracts being awarded by federal agencies. Would these agencies contemplate opening such con-



tracts to foreign providers of such services, that is, to services companies which do not even have Canadian subsidiaries?

## **Non-Market Economies**

The GATT as a text is, paradoxically, almost silent on a major working assumption: that trade is an activity conducted by entrepreneurs independent of government direction reacting to prices as determined in markets to which all have access. Given this view of how trade is conducted, it is logical to take a price mechanism as the preferred technique of intervention. This assumption ignores the existence of "non-market economies." As a practical matter, the market-economy countries in the GATT have had to adopt concepts of bilateral reciprocity in dealing with the socialist economies. Moreover, they have adapted such GATT devices as anti-dumping duties to apply to imports from "non-market economies" in rather contrived forms.<sup>7</sup> We should therefore be skeptical of sweeping statements that the GATT is a "universal" system. Moreover, we have to think out whether we wish to develop rules on services between the market economies only or whether we wish to include the non-market economies in the services "system." The answer, of course, may depend on the sector at issue. It has been suggested that one possible principle in a general agreement on traded services would be a "right to deliver a service in all markets;" it seems to me that it is unlikely that services industries in market economy countries can secure a right to deliver a comprehensive range of services to customers in non-market economies.

There are, in fact, a number of difficult issues emerging with respect to the non-market economies in the services sectors. For example, there is the extent to which Soviet shipping is being aggressively subsidized, to the apparent detriment of shipping firms based in market economies.

## **"Intolerable" Import Competition**

A great deal of day-to-day trade policy discussion turns on the details of particular cases in which governments assert their fundamental right to protect domestic producers against "intolerable" import competition. The definition of "intolerable" is, of course, a matter for the national political process. This is the basis of Article VI of the GATT, which permits action against dumped or subsidized exports that cause or threaten material injury to domestic producers, and Article XIX, which permits action to limit imports which, while not dumped or subsidized, cause or threaten serious injury to domestic producers.

Action under Article VI is the subject of very detailed procedural provisions developed in the Kennedy and Tokyo rounds. While these codes were developed, anti-dumping and anti-subsidy action were

becoming much more important — indeed, they were becoming the central trade regulating devices in the United States and the EEC. They are central in the sectors outside the area of “managed” trade and even, as in the case of steel in the United States, provide the initial rationale (the “trigger price”) for what is now a regime of managed trade. Managed trade, together with Article VI measures, have displaced the tariff as the central trade policy device.<sup>8</sup>

If we look at Article XIX, the GATT “escape clause,” we should realize that the real value of the GATT to small countries has been that it secured to them some protection against discrimination by the more powerful countries. This has been abandoned in regard to textiles and clothing, and the principle of non-discrimination in the context of emergency protection is under attack, primarily by the EEC.

It is fair to say that European trade policy is based on preferences and discrimination, and the EEC seems to want more scope for such practices under the GATT by rewriting Article XIX. The history of the GATT discussions of that article does not suggest that we should rush to extend the GATT to traded services.

It seems difficult not to conclude from these few comments that, in regard to its key concepts, the GATT is no longer effective. That means that the GATT no longer serves adequately the interests of small countries, such as Canada, nor those of the developing countries. If we have a system which, by and large, is not working or which works primarily to protect or advance the interests of the larger entities, then we might at least be skeptical that Canadian interests will be served by trying to extend it to another area of trade.

Clearly, I think not. As I see it, the principal task of trade policy makers in the near and medium term must surely be to consider what sort of trade relations system can be reconstructed, in order to put in place a functionally effective set of rules regarding traded goods. Only then should we worry about the scope for some such system of general rules in regard to traded services.

This perspective does not mean that there are not some elements or concepts of the GATT — and perhaps some notions, or at least phrases, derived from prewar bilateral treaties, such as “national treatment” — which could have application in regard to certain traded services, if carefully delimited as to what measures or devices the obligation is to apply.

## **The Concept of “Unfair Trade”**

One of the most important notions to surface in discussions of the “services proposal” is the extension of “contingency measures,” which are by and large sanctioned by the GATT, to transactions involving services.<sup>9</sup> By “contingency measures” I mean the whole range of legal-



istic measures which can be deployed in defined circumstances to give highly selective and usually discriminatory protection to particular producers deemed to be exposed to unacceptable import pressures. The list of such measures includes anti-dumping and countervailing duties (under GATT Article VI as noted above); action against other “unfair” trade practices, such as alleged patent infringement and trade mark infringement by importations (actionable in the United States before the International Trade Commission under Sections 337 and 337a of the Tariff Act); and measures against “unfair” actions of foreign governments (actionable in the United States under Section 301 of the Trade Act, which covers services, and contemplated in a draft regulation of the EEC Commission). In parallel, there is the regulation of trade in particular products by various means outside the GATT. An example is the limitation on exports of automobiles from Japan to Britain, pursuant to agreement between the auto industries of the two countries. This range of measures or devices, together with the regimes of administered and managed trade such as the Multi-Fibre Agreement and other agreements covering much agricultural trade, as well as so-called “safeguard” measures said to be addressed to “fair” import competition, are trade policy in practice. As I said above, we now have a trade policy system in which the tariff is not the central device; the emphasis is on these more discretionary mechanisms.

Some would agree that, in theory, it would be reasonable to apply anti-dumping duties to dumped services and to apply countervailing duties to subsidized traded services.<sup>10</sup> There is a superficial logic here. Of course services can be dumped or subsidized, and perhaps there may be some disturbances in markets due to such dumping or subsidization. But this does not in itself make a case that we should extend the particular regimes developed with the sanction of the GATT to these services trade problems. It is important to keep in mind that these GATT rules were developed primarily to put some procedural harness on national administrations which were making extensive use of these restrictive measures. The thrust of the particular GATT rules, at least prior to the Tokyo Round, was to limit the use of these devices, which were established in national legislation before the GATT was devised.

International agreements which were devised to limit recourse to these measures and to discipline governments would, if transferred and applied to services, be converted into remits to take restrictive actions of kinds which are not contemplated in existing legislation. Is this what the protagonists of a “services negotiation” want? Perhaps so.

Would it be “liberalization,” would it be “freeing” trade, would it be maximizing the scope for gains from trade, to extend “contingency measures” and the systems of management developed in relation to trade in goods to trade in services? Surely not.

It may be that in Canada we should think more carefully before starting down this particular road, as contemplated in Subclause 48(b) of Canada's Special Import Measures Act. That subclause authorizes the Canadian Import Tribunal, if requested by the Governor-in-Council, to enquire and report in relation to "the provision, by persons normally resident out of Canada, of services in Canada that may cause or threaten injury to, or that may retard, the provision of any services in Canada by persons normally resident in Canada."<sup>11</sup> Once we subscribe to the notion of "injurious" imports of services, we may find that we have started to build a contingency system for traded services. Like the contingency system for traded goods, it will work against the interests of smaller countries.

This point is worth emphasizing and reiterating. It is important to understand that the Tokyo Round agreements on anti-dumping and countervailing duties have been, by and large, to sanction the putting in place, by the United States and the EEC, and in due course, by Canada, of highly legalistic and procedurally complex arrangements to restrict imports. In my view, the anti-dumping and countervail systems as they now stand should be subject to careful scrutiny. The goal would be to secure agreement that they be deployed only when imports cause real damage, clearly beyond the impact of acceptable competition.

It may well be that anti-dumping action, like action against domestic price discrimination, should rarely be invoked. As for subsidies, it seems to me that in a period when many or most governments are in one way or another subsidizing a very wide range of production for export and for import replacement, there is practically no case for an activist countervailing duty system of the sort of complexity sanctioned by the GATT Tokyo Round code.

In sum, we should be revising and circumscribing these arrangements, and doing so as a matter of priority; we should not contemplate extending them to services. The suggestion that there is some sort of respectable intellectual case for applying Article VI measures or introducing the concept of "injury" to a domestic industry — which has surfaced in "liberal" trade circles in the United States and in our Special Import Measures Act — is really extraordinarily unhelpful to the cause of trade liberalization. At a meeting in 1982 at the Institute for International Economics in Washington, I labelled such a proposal as revealing the extent to which the oratory about "unfair" trade practices has subverted the movement to liberalize trade; I have not changed my view. U.S. Ambassador Brock's professional advisors in the United States Trade Representative's Office seem to understand this problem and have addressed the issue cautiously.<sup>12</sup> What the United States will make of the Canadian proposal cited above is not yet clear. My concern is that there are some in the services sector who may welcome it.



## Other Sources for Rules

If the GATT is not an adequate analogue of a possible set of general rules for traded services, it would be legitimate to ask just what other components of the trade policy system should be looked at. For example, if we were to negotiate about shipping, which one British minister has said would be imperative on any general “services negotiation,” one could not ignore the UNCTAD liner code. One would have to consider, across a range of services, the relevance of the UNCTAD code of conduct on restrictive business practices. More generally, we would have to review the OECD code on invisible transaction.

The existence of the OECD “Code of Liberalization of Current Invisible Operations,” adopted in 1961 (with reservations by Canada and others) raises some interesting issues. Why is the arrangement, which on the face of it provides an extensive basis for the “liberalization” of service transactions, not adequate? Alternatively, why is the United States not proposing that the code be extended rather than that another one be built from scratch? The U.S. study (pp. 86–87) sets out a view of what is wrong with the code. First, being an OECD code, it is not subscribed to by developing countries. Second, reservations and derogations can be maintained too easily. Third, effective enforcement mechanisms and provisions for compensation are lacking. Fourth, the code covers transactions and transfers but not the right of establishment, national treatment or the right to conduct business (which is critical for such key services as data processing).

This is a fair assessment, but one is tempted to conclude from the long experience with this code, as worked out between industrialized countries, that progress is unlikely to come from negotiating general rules about services, and accordingly that more detailed specific-sector approaches may be more productive.

It seems to me that the onus remains on those who argue for substantial effort to be directed toward the formulation of general rules and the launching of multilateral, multisector negotiations in which developing as well as industrialized countries would be participants, to show that it is practical and possible, by proceeding in the fashion they urge, to achieve what all trading nations will accept as improvements in the existing universe of rules covering traded services. It is not enough to point to some restrictions on trade in services which some interested private parties may wish to see removed and other interested parties may wish to see retained, or even to argue, as has Ambassador Brock, that “barriers to trade in services are increasing.” It is essential to show that they can be negotiated away multilaterally and by the devising of general rules, and that they cannot be negotiated away in some other more limited and much less costly fashion.

## The U.S. Position

The proposal to negotiate about the removal of restrictions on trade in services, and perhaps to put in place some general rules — as yet not completely formulated — is a proposal about how to go about advancing the interests of particular service corporations in the United States. It involves assumptions about the usefulness and practicality of multilateral negotiation to achieve certain ends. It is assumed, for example, that negotiating for general rules in a forum in which all traded services sectors are discussed will result in a bigger and better bargain — that is, better for the U.S. industries concerned. It is argued that the scope for bargaining will be greater in a larger forum and that it will be possible to use a threat of action or reaction in one sector, including goods sectors, to gain objectives in another sector. This view of the outcome of complex intergovernmental negotiations is being advanced with great conviction, and with the occasional show of contempt for contrary views, by representatives of private interests with little experience of large-scale intergovernmental negotiations. That does not, of itself, make their views invalid, but it is not a compelling argument for giving them great weight.

Other assertions about the utility of negotiations deserve equal time. One is that such a multilateral negotiation would either never reach any useful conclusions or, if it did, that this could be achieved only through the United States and the EEC imposing their will on others. That was our experience, unfortunately, in the Tokyo Round. Such a process is bound to yield very unsatisfactory results for many other countries, including Canada. As a technique of conducting relations between states, it is quite damaging to the multilateral system. Moreover, we should note that when general rules were being negotiated — as on subsidies and countervail — the Tokyo Round produced not only an inadequate but perhaps necessary result, but also certain perverse, negative and, in the end, damaging effects. By contrast, it was when sector-specific rules were being negotiated, as in the aircraft sector, that the most positive and useful results were achieved. Multisector negotiations can provide opportunities for striking imaginative bargains, if the will is there. They can also provide great scope for blocking tactics, if the will is there, and for working to a hidden agenda. Single-sector bargaining can at times produce substantial results, as in aircraft, if the will is there.

There is also the stated assumption that bringing in the multilateral dimension — the technique of the multilateral conference — will somehow produce more substantial results than will less structured bilateral discussion. To take a case in point, there have been difficulties encountered by U.S. insurance firms trying to sell insurance in certain developing countries (e.g., Korea). It is said that there has been discrimination in the sense that U.S. firms established in those countries are denied “national treatment.” Is it really the case that a developing country, or a



developed country for that matter, will agree to U.S. demands more readily if there is some international set of rules, vaguely formulated and shot full of exceptions, than it will if a bilateral treaty, say a Friendship, Commerce and Navigation (FCN) treaty, cast in fairly precise language, is invoked? Little in recent commercial policy experience would lend support to such a proposition.

When we look at U.S. proposals in the light of these considerations, their character becomes somewhat clearer. In what I take to be the most authoritative short statement of the U.S. proposal — Ambassador Brock's "Simple Plan"<sup>13</sup> — the emphasis is on making all restrictions on trade in services and barriers to investment negotiable, extending the concept and scope of "national treatment," developing contractual rights, and putting in place a dispute settlement mechanism. To developing countries such a scenario opens the possibility that they will be threatened with the loss of access for their manufactured exports to the U.S. market if they do not open their markets to U.S. services firms.<sup>14</sup> This is, in fact, precisely what is being proposed in the U.S. Congress with regard to extension of the Generalized System of Preferences for developing countries' manufactures. The clearer this becomes, the more likely it is that developing countries will resist the proposal to negotiate about services in general anywhere, and certainly in the GATT. Nor have they forgotten the extraordinary pressure applied by the U.S. Treasury on the Brazilian authorities to force them to be more accommodating about the U.S. services proposals during the GATT ministerial meeting of November 1982; that episode has induced skepticism or at least considerable caution.

## **A Modest Proposal**

All this is not to deny that it may be possible to devise some rules that could improve, at least marginally, on the complex international order covering trade in services. It would, in my view, be useful to have a multilateral examination, a study of the whole body of commercial policy arrangements — GATT, OECD (particularly the codes on invisibles and on capital movements), UNCTAD, FCN treaties, arrangements regarding particular sectors (such as the Chicago convention establishing the International Civil Aviation Organization and its subordinate arrangements) — to see if some analogues or mix of model provisions can be devised which might be useful for particular sectors or in particular contexts. But it seems pretty clear that the GATT, given its history and its demonstrated lack of effectiveness, is not the appropriate analogue. It might be that such an examination would find that particular treaty provisions or commercial policy concepts are best deployed in bilateral arrangements, perhaps in revised FCN treaties, rather than being deployed in what might become, at a multilateral level, no more than

codes of conduct — that is, arrangements without binding force and carrying no promise of an exchange of rights and obligations on a contractual basis. Whether such a modest but workmanlike approach would be acceptable in Washington is not clear. For the present, the United States appears to be approaching the services issues in an unduly adversarial, almost combative style. U.S. representatives are managing to convey the impression that they are determined to open the markets of other countries to U.S. services companies, and that a great deal of negotiating leverage will be used to that end. It seems not to be understood that many other countries have objectives — such as “development” and “sovereignty” — which are as important to them as the gains from trade are to the United States. While there are gains from trade in the services sector, their importance in comparison with other gains may be difficult to determine for many countries.

It is not clear, therefore, that Canadian interests will be served by associating Canada too closely with the current U.S. strategy.

## **The Information Component**

One element which is becoming more prominent in the advocacy of the “services proposal” may provide a partial basis for a more productive approach. This is the proposition that what is really at issue in the debate about traded services is a set of problems relating to the international movement of information. The information industry, with its modern technology involving data processing, transmission across borders and complex computer programming, is itself a service industry for the “smokestack” industries and for consumers, and also an important intermediate service for a wide range of services industries — such as engineering and consulting, banking and insurance. The implicit view in some of the recent statements of the “services proposal” is that this is really the central issue. Whether, if we address the information policy complex, we will find that more can be achieved multilaterally, or bilaterally, or both, it is perhaps too early to say. It has been observed, however, that at the multilateral level, it might be difficult to negotiate the emerging information issues in the International Telecommunications Union, although it is under the ITU auspices that the necessary product and services “standards” or “norms” are being developed and agreed to. If we do tackle the information technology complex directly, particularly the transborder data flow issue, we will be addressing a big piece of the “services” issue. It is likely that the most intractable issue will be that raised by U.S. assertions of extraterritorial jurisdiction and the various implications they will have for the use of computer systems.<sup>15</sup>



## The Canadian Interest

What about the Canadian interest? Clearly, if the United States continues to give high priority to the “services proposal” — as seems likely under the present administration — we must be more fully informed ourselves. The Federal Task Force on Services addressed their remit fairly comprehensively and rapidly; Canada is, as a practical matter, rather ahead of the parade. (It is for this reason that I have confined myself in this paper largely to the negotiation issues.) It seems to me that there are three observations about the Canadian interest which are relevant.

First, in regard to my last proposition that one way to address the services complex would be through the information component: there is in Canada an apparent conflict between some enterprises in the information industries which are attempting to export their services, and others which seek protection of the Canadian market and may seek to rationalize their concern with assertions about “sovereignty.”

Legitimate sovereignty considerations will be very difficult to define; they may be real but it will be easy to overstate them, particularly for the technologically illiterate — which is most of us. In this regard, it is surely the case that Americans have made far too much of our Bank Act requirement that certain banking data required for the Inspector General of Banks to carry out his regulatory function must be held in Canada. The requirement is minimal and not unduly restrictive of trade. However, on the other side, there are Canadian computer service companies competing in international markets whose interests would be adversely affected by restrictions on transborder data transmission. Of course, the dimensions of the problem may shift with technology; the present pattern of computer use, which dictates that some computers must be used by users abroad if they are to be operated most profitably, is related to the design of hardware and programs and to the relative costs of hardware, software and transmission. These are unlikely to stay fixed. If we do negotiate about this key sector, it is likely that the real issue will not be “sovereignty” as invoked for protectionist purposes, but rather the impact on “sovereignty” of U.S. assertions of extraterritorial jurisdiction. That impact will be the greater as traded computer services become increasingly relied upon.<sup>16</sup>

My second observation on the Canadian interest is that in regard to traded services, as in regard to traded goods, the rules evolved by our larger partners are likely to be biased in favour of larger markets. Professor John Jackson, a leading U.S. expositor of the GATT rules, has often argued the utility of a “rule-based” system of commercial policy relations as preferable to a “power-based” system. My worry is that the result of negotiation can be a set of rules that buttress existing power rather than moderate it: rules developed by the big powers are likely to

be "power-biased." The Tokyo Round agreement on countervail shows how this can happen; that is an important reason why the GATT should not be an analogue for the services sector. It is not at all clear that Canadian interests can be advanced in a services negotiation of a broad and generalized character, in which the two big entities will make the agreements, rather than in negotiation of a detailed and essentially sectoral character.

The third observation I must make is that none of the literature on services makes an effective case for giving up overwhelming priority to the "services proposal"; the priority being accorded in Washington is simply a reflection of the lobbying skill of particular interests. The priorities for governments are surely improving international monetary management; achieving more stable growth; bringing some sort of order to those sectors of traded goods where there is now autarchy and anarchy — e.g., to the trade in steel, textiles, agriculture, autos; and doing something about the access to industrial markets of the manufactured exports of developing countries. The Canadian interest, in broad economic and narrower trade terms, and in terms of foreign policy, particularly in regard to the major developing countries in the Americas, remains very much involved in these issues.

## Notes

This paper was completed in January 1985.

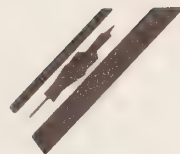
1. See Canada, Task Force on Trade in Services, *Final Report* (Ottawa: Minister of Supply and Services Canada, 1982); the *Background Report* submitted to the GATT does not include Section F of the original task force report.
2. United States, Office of the U.S. Trade Representative, *U.S. National Study on Trade in Services* (Washington, D.C.: U.S. Government Printing Office, 1983); United Kingdom, Department of Trade and Industry, *Trade in Services: The U.K.'s National Examination* (London: HMSO, 1984).
3. For a detailed study of the change in industrial structure, and of employment brought about by the rise of "services," see Jonathan Gershuny and Ian Miles, *The New Service Economy* (London: Pinter, 1983).
4. The statistics in the *World Development Report* for 1980 suggest that 65 percent of Canadian GNP is produced by services and that 64 percent of employment is in services (as of 1978). A study by V.K. Ranga Chand, *The Growth of the Service Sector in the Canadian Economy* (Ottawa: Ministry of State for Science and Technology, 1982), confirms these figures and suggests that the importance of services in the Canadian economy has been underestimated for some time. These citations and figures are drawn from material prepared for the Canadian federal Task Force on Trade in Services.
5. See, for example, Canada, Task Force on Trade in Services, *Final Report*, p. 16: "Canada's service account receipts in 1981 amounted to \$14.9 billion while our payments in this category totalled \$29.7 billion, resulting in an overall deficit position of \$14.8 billion on service account. . . . This . . . can be traced almost entirely to Canada's growing deficit in terms of interest dividend and miscellaneous investment income payments."
6. The two forms of the most-favoured-nation clause are examined in detail in the *Yearbook of the International Law Commission* for 1969, 1970 and 1977.



7. These forms are necessarily contrived because normal values are determined by reference to export prices from a market economy. For a discussion of the problems posed by trade with non-market economies, see Richard Dale, "Dumping Problems in East-West Trade," in *Anti-Dumping Law in a Liberal Trading Order* (New York: St. Martin, 1981), chap. 7.
8. For a discussion of the role of the tariff and the rise of managed trade and contingency measures, see Rodney de C. Grey, *United States Trade Policy Legislation: A Canadian View* (Montreal: Institute for Research on Public Policy, 1982).
9. See Michael Cohen and Thomas Morante, "Elimination of Non-Tariff Barriers to Trade in Services: Recommendations for Future Negotiations," *Law and Policy on International Business* 13 (2) (1981): 495–519.
10. For useful comment on this issue see William Diebold and Helena Stalson, "Negotiating Issues in International Services Transactions," in *Trade Policy in the 1980s*, edited by William R. Cline (Washington, D.C.: Institute for International Economics, 1983).
11. See *Notice of Ways and Means Motion* of December 20, 1983, including the proposed Special Import Measures Act, p. 43.
12. See U.S. Office of the U.S. Trade Representative, *Study*, pp. 92–93.
13. William E. Brock, "A Simple Plan for Negotiating on Trade in Services," *The World Economy* 5 (3) (November 1983): 229–40.
14. See Harald Malmgren, "New Restrictions on GSP," *World Trade Outlook* 6 (1) (1984): 7–8: ". . . the Administration wants authority to negotiate eligibility (for GSP) not only on a product-by-product basis, but also a country-by-country basis to seek improved access for American goods and services in developing country markets. Included in the new Administration objectives would be . . . elimination of performance requirements on foreign investment, improved protection of American intellectual and technology rights in those countries, and non-discriminatory treatment of American firms providing such services as insurance, banking and accounting."
15. I have recently explored these issues in more detail in a study published by the Royal Bank of Canada; see Rodney de C. Grey, *Traded Computer Services* (Montreal: Royal Bank of Canada, 1983). Rowland Frazee, chairman and chief executive of that bank, has urged that Canada and the United States should address this issue as a matter of priority; see Rowland C. Frazee, *Trade and Technology: It's Canada's Move* (Montreal: Royal Bank of Canada, 1983).
16. See Rodney de C. Grey, "The Canadian View on Extraterritoriality and Export Controls," paper presented to the Trilateral Conference on Extraterritoriality, Los Angeles, 1983.







## Non-Tariff Barriers and Canadian Trade Policy

### *Summary of the Proceedings of a Research Symposium*

COLLEEN HAMILTON AND  
JOHN WHALLEY

As tariff barriers have been reduced in the postwar world, discussions of global trade issues have increasingly focussed on non-tariff barriers as major impediments to trade. Many of the trade policy disputes that have attracted attention in recent years have centred not on the more traditional instruments of trade policy such as the tariff, but on less traditional arrangements such as voluntary export restraints, orderly marketing arrangements, and trigger price mechanisms. These policy instruments are all classified as non-tariff barriers.

The issues of non-tariff barriers and Canadian trade policy were discussed in a symposium held by the Commission's Research Group in Economics on December 2, 1983, in Ottawa. Participants are listed in Appendix B. Three papers were presented: by Sandy Moroz of the Institute for Research on Public Policy, Ottawa; Peter Morici of the National Planning Association, Washington, D.C.; and Professor Ronald Wonnacott of the University of Western Ontario, London. (These papers are published in *Canada – U.S. Free Trade*, volume 11 of the Commission's research series). In addition, Jan Tumlrir of the GATT Secretariat prepared notes for the symposium which were not formally presented. A panel discussion followed the presentation; panel members included Douglas Newkirk of the Office of the United States Trade Representative, Washington; John Weekes of the Department of External Affairs, Government of Canada; and Peter Williams of the GATT Secretariat.

Non-tariff barriers have a mixed reputation. Some argue that they are widely used by countries to offset the effects of the reductions in tariffs produced through negotiating rounds of the General Agreement on

Tariffs and Trade (GATT). According to this view of the world, countries participate in GATT rounds to reduce their tariffs and simultaneously offset the effects of these reductions through other restrictive instruments. In many cases, these non-tariff barriers are relatively inefficient instruments which have an even more restrictive impact than the tariffs themselves and are difficult to detect. As a result, analysts attach a high priority to moving beyond the trade liberalization achieved thus far in the GATT to focus on these barriers.

Others argue that the prominence being given to non-tariff barriers is itself a reflection of the reduction of tariff barriers. Non-tariff barriers have always been present — they are only more apparent today than earlier. This is the so-called waterline hypothesis — that as tariff barriers have been reduced, non-tariff barriers have become more visible. The implication is that trade liberalization should now proceed to concentrate on the elimination of non-tariff barriers rather than tariffs.

For Canadians attempting to conduct trade policy with a variety of countries, the presence of non-tariff barriers poses a series of perplexing choices. If it is true, for instance, that non-tariff barriers have become increasingly more severe as tariff barriers have been reduced, it may be reasonable to question the extent to which Canada has succeeded in obtaining increased access to foreign markets as a result of trade liberalization under the GATT. In turn, these doubts contribute to a somewhat pessimistic view about the potential benefits for Canada from further GATT negotiations. On the other hand, those who subscribe to the waterline hypothesis believe that the multilateral framework has served Canada well and that a renewed commitment should be made to the GATT in order to achieve reductions in non-tariff barriers that would give Canada increased access to foreign markets.

A related issue concerns the choice between a bilateral and a multilateral focus for Canada's trade policies. If one argues that non-tariff barriers are far more complex than tariff barriers and are more difficult to negotiate and to define, the problems of attempting to deal with non-tariff barriers in a multilateral forum such as the GATT may appear close to insuperable. Since the non-tariff barriers which are most important to Canada are those used by its major trading partners — the United States, the European Community and Japan — a major move on the non-tariff barrier issue may well argue for increasing the degree to which Canada's trade policies are bilaterally focussed.

A further issue concerns the appropriate conduct of Canada's trade policy if it is true that some non-tariff barriers abroad help us. If, for example, discriminatory trade barriers are used in the United States against a third country such as Japan, Canada benefits from increased access to the U.S. market because of the discriminatory nature of the barrier. Thus, a multilateral code on a particular non-tariff barrier covering all markets abroad would not always be in the Canadian interest.



Complicating this set of questions is the issue of measurement and data. The list of non-tariff barriers in the current GATT inventory (Appendix A) is long, and obtaining estimates of their severity is a daunting task. There is no general agreement as to whether these barriers have become more or less severe over time or indeed how severe they are in terms of their impact on world trade.

## **The Definition of Non-Tariff Barriers**

Non-tariff barriers may be defined as any trade-distorting measures that operate in addition to tariffs. These barriers include a range of government actions that change the volume, commodity composition or direction of international trade. They are often used to improve the competitive position of domestic industries, but non-tariff measures may simply be a side effect of domestic policies. Because not all these actions need involve barriers as such, the GATT decided in the mid-1970s to use the term “non-tariff measure” rather than “non-tariff barriers.” In this and other Commission papers, however, the more familiar term — non-tariff barriers — is used.

Non-tariff barriers (NTBs) might include the following: quotas, government procurement policies, differential standards, customs valuation procedures, administrative procedures, subsidies, licensing arrangements, trigger price mechanisms, orderly marketing agreements, voluntary export restraints, countervailing duties and anti-dumping duties. All these measures are actions that either by accident or by design discriminate against foreign suppliers in favour of domestic suppliers, usually at the expense of domestic consumers and taxpayers.<sup>1</sup>

## **Non-Tariff Barriers and the Postwar Trading System**

The primary purpose of the General Agreement on Tariffs and Trade was to record the results of an initial tariff-reducing conference in 1947. The GATT was considered a temporary arrangement that would be in force until the ratification of the Havana Charter of the International Trade Organization (ITO). Therefore, it is not surprising that the GATT has been unable to deal effectively with non-tariff barriers. The existence of NTBs is explicitly recognized in Part II of the GATT, but NTBs were intended for use solely on a temporary basis for balance-of-payments purposes and to assist other major adjustments due to the war. The intention of the relevant codes in the GATT was never to foster protection for domestic industries but to facilitate the reduction in impediments to trade on a global basis.

In the early years of the GATT it was intended that all NTBs would be abolished as soon as balance-of-payments difficulties permitted, and that all protection should eventually be in the form of more transparent

and negotiable customs duties. Unfortunately, the GATT included a protocol of provisional application — a grandfather clause — which exempted signatories from GATT rules in cases where pre-GATT legislation contradicted Part II of the GATT. Countries that had become used to non-tariff forms of protection in the postwar world were less willing to abolish existing means of protection, because of the potential difficulties created for domestic industries in adjusting to market penetration by foreign competition. At the same time, protectionist sentiment had been growing in many countries and continued efforts to rid the international trade system of NTBs were thwarted.

With the failure to ratify the charter for the ITO, the General Agreement was left as the only vehicle through which postwar international trade could be regulated. In the postwar years the GATT has served its main purpose well — namely, to serve as a framework within which tariff barriers could be reduced. By the end of the implementation period under the Tokyo Round negotiations, in 1987, tariffs on most industrial products in the major advanced economies will be in the range of 5 to 6 percent. However, the way NTBs have evolved under this system is another matter.

There is in fact, as mentioned earlier, a range of views on what has happened to NTBs under the postwar trading system. One view is that countries have offset the reduced protection negotiated through tariff cuts by increasing their use of new NTBs. A second view, referred to earlier as the waterline hypothesis, contends that NTBs have always been present but are more visible now because of the reduction in tariffs.

Differentiating between these two views is difficult since there is evidence to support both. One can point to the recent proliferation of voluntary export restraints, orderly marketing agreements and trigger price mechanisms, and to the increased use of subsidies. On the other hand, non-tariff barriers have always existed, as is evident by looking at the 1947 General Agreement. A combination of these two views probably characterizes the present situation.

Part of the difficulty with NTBs arises from problems of definition and control. In 1967, the contracting parties to the GATT supplied information on NTBs encountered in member countries. The industrial committee of the GATT consolidated this information and compiled a list of 800 non-tariff devices. Ultimately, this list was reduced to 30 items, in spite of the many disguises NTBs can take.<sup>2</sup>

The difficulties of detection and definition are reflected in the difficulties in controlling NTBs, not to mention the animosity these issues tend to foster in trade negotiations. At present, there is in the GATT no sound monitoring, surveillance or disciplinary procedure to deal with NTBs. NTBs were first subjected to scrutiny and negotiation in the Kennedy Round. The intent behind deciding to include NTBs in the Kennedy Round negotiations was only to consider trade measures used



directly by governments or measures that could be removed without essentially changing the protection given to individual industries.<sup>3</sup> Measures selected for attention were government procurement, valuation procedures for imports, the administration of technical regulations, and internal and quantitative restrictions. Negotiations for the most part did not progress beyond the agreement to establish negotiating groups. Two major exceptions were the modification of certain NTBs, such as the American selling price, which was combined with tariff concessions in the settlement reached in the chemical sector, and the agreement on a code of behaviour in anti-dumping practices.<sup>4</sup>

Discussions on NTBs continued in the Tokyo Round. In meetings of the preparatory committee in 1973, a list of priority items was proposed. Included were import subsidies and countervailing duties, government procurement, valuation procedures for customs purposes, standards (including packaging and labelling), quantitative restrictions (including embargoes and export restraints) and licensing systems. Import documentation and consular formalities were also included.<sup>5</sup>

Agreement was reached early in the negotiations on codes of conduct covering industrial standards and certification procedures, government procurement policies, government valuation practices and import licensing. A new code on subsidies and countervailing duties was also adopted. The European Community proved to be the main impediment to including a new safeguards code covering emergency actions against surges of imports of particular products. The EC argued for the right to use selective safeguard actions.<sup>6</sup>

Thus, experience with NTBs under the GATT has been somewhat mixed. Some progress has been made, but a range of NTBs has not been formally included in the GATT. And where a substantive attempt was made to deal with one of the major issues, namely the safeguards issue, it proved impossible to reach an agreement.

## **Key Non-Tariff Barriers Canada Faces Abroad<sup>7</sup>**

Producing a complete list of non-tariff measures Canada faces in its major markets is a long and difficult research task. The list given here serves only to indicate the broad features of the barriers Canada faces abroad.

Canada's major export market is the United States and the policies that usually attract major attention from Canada involve "Buy American" laws and regulations; the Surface Transportation Assistance Act, which requires that federal funds spent on transportation equipment be used to buy products from domestic producers; the Domestic International Sales Corporation and its successor the Foreign Sales Corporation, which provide an export subsidy through the tax system; the increased legalization of American trade policy, with the use of the legal

system to thwart attempts by importers to penetrate the U.S. market; the use of countervailing duties; and the implications for Canada of various safeguards measures the United States either considers or adopts.

In Canada's dealings with the European Community, the key issues involve preferential access granted to certain countries or groupings, such as the European Free Trade Association; the Common Agricultural Policy and its impact through agricultural subsidies, standards and administrative procedures used in the EC; and government procurement practices.

In Japan, a whole range of policies operate, including quantitative restrictions subject to variations, inconsistencies and complexities of various kinds; quotas; technical barriers; industrial standards; the non-acceptance of Canadian test data; rigorous customs enforcements with no appeals procedure; government procurement practices; government subsidies and research grants in key developing industries; the control of the ministry of finance over foreign direct investment; and discrimination against foreign freight carriers in access to Japanese facilities. In addition, prohibitions, restrictions or changes are frequently made to regulations affecting foreign countries.

Canada also faces significant NTBs in other markets, including state trading operations in Eastern Europe, import licensing procedures in less developed countries, such as in Africa and Asia, and comparable restrictions to alleviate balance-of-payments difficulties in Latin America.

In all these markets, then, Canada faces major NTBs and, as was highlighted in the symposium, the conduct of trade policy in light of these barriers is a major issue for policy makers.

## **Non-Tariff Barriers in Canada**

An issue raised at the symposium was whether it is true, as is often supposed, that whereas the rest of the world adopts non-tariff measures that prohibit Canada's exports from penetrating foreign markets, Canada has no such policies.

Unfortunately, this is not the case, and when dealing with Canada foreign countries usually produce a list of non-tariff measures Canada is accused of using. In turn, Canadians usually perceive these measures to be issues concerning mainly domestic economic policies. Two major issues raised in recent years by the United States are rules governing the operation of the Foreign Investment Review Agency (FIRA) and a number of features of the National Energy Program. Recently, for instance, there has been a reference to a GATT panel on the local content provisions applicable in FIRA rulings.<sup>8</sup>



In addition, such issues as the policies of provincial liquor boards, marketing boards, government procurement practices at both federal and provincial levels, and provincial laws regarding export restrictions of minerals have attracted the attention of foreign governments. Other issues have been the bilingual labelling requirements on mass-produced goods, which the United States has argued is an NTB, and the implications of metrication.<sup>9</sup>

## **Trade Policy in Light of Non-Tariff Barriers**

Given that NTBs exist, it is clearly important to analyze the various options for Canada's trade policies, and the discussion in the symposium reflected this concern.

### ***The GATT Option***

It is generally agreed that the GATT should provide the major institutional framework through which to control NTBs, but that there are enormous difficulties in trying to regulate NTBs within this framework. It is difficult to achieve a consensus among members on which barriers to negotiate. There is no common basis of measurement to apply across the board to help negotiators formulate their positions or offers. There is a problem with the most-favoured-nation (MFN) principle, since many countries wish to use NTBs selectively to protect domestic industries against particular suppliers.

Different approaches have been suggested to deal with the NTB problem. One is a general, multilateral approach with dispute resolution through GATT panels. Another is a barrier-by-barrier approach, attempting to establish rules of behaviour for NTBs not covered by the GATT. Some have suggested the withdrawal of the protocol of provisional application, to transform the GATT rules on non-tariff measures into binding international obligations.

A set of rules covering non-tariff measures also needs to facilitate multilateral reductions of existing measures and to limit their introduction. There is therefore a need for a strong monitoring system and dispute settlement procedure. It has also been suggested that there would be a need for an adjustment assistance code before any significant reductions in NTBs on an international scale could be considered, since most countries would want to use trade adjustment assistance programs to facilitate the changes that removal of protection would imply. Some have suggested that the GATT Secretariat should provide data for negotiations, perform surveillance functions, and even initiate actions in the event of non-compliance with the codes.

## *The Bilateral Option*

The bilateral option would involve an attempt to negotiate bilateral arrangements with major trading partners outside the framework of the GATT but compatible with GATT obligations. It is often alleged that U.S. actions involving NTBs are directed against other countries and are not intended to affect Canadian trade adversely. Although this assertion may be true, there are barriers in the United States which are significant to Canada, such as the Surface Transportation Assistance Act. In addition, the risk of safeguards measures being taken by the United States and adversely affecting Canada, as recently seemed likely in the cases of steel and copper, could possibly be reduced through bilateral negotiations.<sup>10</sup> It is a question, however, of whether Canada could exert enough influence to change U.S. non-tariff measures, especially if they had to be administered on an MFN basis.

## *The Unilateral Option*

A final option for Canada is to control its own NTBs unilaterally. Over the years, some commentators on Canadian trade policies have argued that the major losers from NTBs are the nations imposing these barriers and that the barriers reflect internal political pressures for protection from narrow producer interests as distinct from the national interest. To the extent that this is so, clearly the unilateral option may offer a desirable route.

Many of these issues were considered in the symposium. The dominant themes were the complexity of current non-tariff measures in use in world trade and the relative absence of data. This makes an appropriate stance on trade policies on these matters difficult to determine. The areas of agreement were the primary importance of NTBs in the present global trading system and the need for all countries, including Canada, to move forward in attempts to limit the use of NTBs.

## **Summary of Symposium Papers**

In notes prepared for the symposium, Jan Tumlr of the GATT Secretariat made several observations on NTBs and ways of dealing with them. According to Tumlr, the term NTB has become a "euphemism which distorts our sense of priorities." He categorized NTBs in order of decreasing importance as quantitative restrictions, subsidies, dumping, product standards, customs valuation procedures and government procurement. In his opinion, everything following quantitative restrictions is better termed an annoyance than a barrier. He also stated that all items involving subsidies were dealt with satisfactorily in the Tokyo Round. The issue he proposed as deserving much more attention is cartelization



in international trade — that is, arrangements that protect producer interests in several countries at the expense of consumer interests.

Tumlir noted that only “hard-core residual” NTBs were widely used before World War II, and that these barriers compose only a small part of the NTBs now in use. He noted that voluntary export restraints (VERs) and orderly marketing arrangements (OMAs) were used in the 1930s by the United States and other countries in dealing with Japan. Tumlir referred to estimates suggesting that the proportion of world trade currently conducted outside the GATT system or in defiance of its rules is approaching one-half. This fact, he suggested, was evidence of the extent to which trade policy arrangements outside the GATT (and principally quantitative restrictions) influence our present global trading system.

In his symposium paper, Ronald Wonnacott took issue with some of the proposals put forth before the symposium by the Lavelle-White task force report on the auto industry (LW) and reflected on the relationship between political sovereignty, the GATT system and NTBs in general.

One observation Wonnacott made on the appeal of NTBs as protective devices was on their hidden nature. That is, they are a “way to protect in a disguised way, in the hope of getting away with it.”

In Wonnacott’s view, everyone loses if NTBs lead to the erosion of the GATT system. While it can be argued that the erosion of Canada’s trade agreements increases Canada’s sovereignty, Wonnacott gave reasons why on balance the opposite is likely to be true. For example, he used the LW report to illustrate how the government can resist special-interest, protectionist pressures by pointing to Canada’s legal obligations under the GATT.

Looking specifically at the LW report, Wonnacott found particularly disagreeable the recommendation to establish Canadian content requirements for Japanese auto manufacturers. Such requirements would not only unilaterally alter Canadian commitments to the Auto Pact but would also force Japanese manufacturers into a Canadian production location, thereby allowing them to use the Auto Pact to bypass the present voluntary export restraints that limit their entry into the United States. Since the alternative to meeting the LW Canadian content requirements is not to sell in Canada at all, it is easy to see why neither the United States nor Japan would be content to have Canada implement such restrictions. In Wonnacott’s view, since this restriction would, in effect, be a prohibitive Canadian tariff, it would not only effectively break Canada’s Tokyo Round tariff binding on autos but would jeopardize the Auto Pact, since it is unlikely that this restriction could withstand an American review, given the present state of the U.S. auto industry.

In concluding his remarks, Wonnacott stressed the benefits of giving up some sovereignty in order to belong to the GATT — it enables the government to resist internal pressures for protection.

In his paper, Andrew Moroz focussed on the operation of NTBs in Canada. Moroz saw NTBs primarily as a substitute for tariffs "in the face of rising pressures for protectionism." He also noted that even high tariffs have been an ineffective method of protection for some industries and that NTBs give extra safety from threats of foreign competition. He cited as examples the textile and clothing sectors and the Canadian automotive sector, where quantitative restraints are in place and content regulations are currently being advocated.

Focussing on Canada, Moroz illustrated how it has been an active participant in the use of NTBs to provide protection to domestic producers. Canada's NTBs have included voluntary export restraints, escape clause actions, subsidies, government procurement policies, and performance requirements under FIRA.

In concluding, Moroz saw the major challenge to negotiations on NTBs as the difficulty of establishing a set of criteria for distinguishing among policy objectives and the difficulty of recognizing and policing the multitude of NTBs. His final concern was the shift toward a more legalistic trade policy system and the further erosion of the most-favoured-nation principle in the GATT.

Peter Morici presented a symposium paper on U.S. trade practices and NTBs. He began by pointing out that even though trade liberalization has been a major goal of the United States since World War II, this process in all advanced industrialized countries (AICs) has been inconsistent across industries, just as it has been across barriers to trade. Morici contended that as tariff reductions were being negotiated in the 1960s and 1970s, the AICs were developing a "system of managed trade and protection through subsidies for many mature industries."

He saw the seven GATT rounds as having made considerable progress in reducing tariffs on industrial commodities and secondary manufactures. However, Morici contrasted the progress made in reducing traditional trade barriers with that made on the remaining NTBs. The implications for Canada of procurement practices, product standards, the Jones Act and the manufacturing clause of the U.S. copyright law were briefly assessed.

Morici asserted that as economic circumstances changed during the 1960s and 1970s, two trends of protection emerged among the AICs. One trend was that AICs increasingly turned to selective protection to manage unemployment in mature industries caused by imports from the newly industrializing countries (NICs) and Japan. Included in this category are orderly marketing arrangements, voluntary export restraints, and market sharing agreements between AICs. In Morici's view, these practices often shift unemployment among AICs without addressing fundamental adjustment problems. He also stressed that these measures can adversely affect Canada even though they may be directed at third country suppliers.



The second trend was conditional protection, which includes domestic production, employment subsidies and export incentives. Morici attributed this form of protection to increased competition among the AICs in technology-intensive activities.

## **Summary of the Symposium Discussion**

The floor discussion reflected the complex nature of the subject matter. As was noted by one participant, NTBs are hard to deal with because they are hard to understand. However, despite the complexities, a few key themes emerged.

### ***The Severity of Non-Tariff Barriers***

A central question was whether NTBs are on the increase or whether the limelight is now on them because tariffs are lower than formerly. If NTBs are on the increase, should Canada attempt to negotiate reductions in them bilaterally?

One panel member pointed out that there are no Boy Scouts in trade policy. Every country provides protection and assistance to its own industries. Focussing on Canada in particular, one panelist asserted that the use of NTBs in Canada has not increased even though there has been some substitution among the various barriers. In addition, he was surprised that there were not more trade barriers in Canada, given the depth of the recent recession.

One participant suggested that NTBs could be divided into two groups: measures which are designed to restrict or distort trade and measures which are designed to protect the health and safety of consumers and have the incidental effect of distorting trade. It was suggested that some countries use the latter measures to restrict imports. For example, it is sometimes claimed that health and sanitary regulations protect the entire Australian agricultural sector.

Another panel member suggested that it would be necessary to look at the individual types of NTBs to determine whether or not they are increasing. He noted that there has been a relatively modest increase in border restrictions such as health regulations, and increased government involvement in commerce.

According to another panelist, multilateral trade negotiations have led to significant reductions in the number of NTBs. In his view, non-tariff measures are on the increase in the areas of tropical products, textiles, steel, automotives and high technology. In addition, there is an increase in the grey areas of voluntary export restraints and orderly market arrangements. He acknowledged that there is an automatic tendency for these measures to proliferate. Apart from that, a more general demon-

stration effect results when one industry gets protection and other industries subsequently demand comparable treatment.

### *The GATT and Domestic Policy Regulation*

Attention was also given to the role of the GATT in the regulation of NTBs. It was noted that the GATT originally dealt with measures taken at the border but that as customs duties came down, there was a tendency for the GATT to interest itself more in internal government policy measures. Such measures were portrayed as something that governments were very reluctant to negotiate internationally in the early years. It was stressed that the intent of the provisions of Part II was to ensure that the advantages of tariff concessions were not nullified.

In one panellist's view, the GATT could have more of an effect on the way programs such as countervailing and anti-dumping are administered at the national level if it tried to do more to regulate the domestic political processes that determine the outcome in cases involving these programs. He further suggested that even though these issues are often cast in legal form, the real issues are political.

Another panel member disagreed with the above suggestion. He argued that depoliticizing decision making in this area by allowing an impartial tribunal to make at least the first determination yields less protectionism and fewer trade frictions in the end than if they are handled at a political level. In his view, an international system based as far as possible on agreed rules is preferable.

One participant also noted that it currently seems that all industrialized countries are trying to promote and protect the same types of industries. He believed that crowding out would result if these developments do not proceed along the lines indicated by comparative advantage. He suggested that it would be useful to coordinate industrial development policies to avoid this situation.

Another participant asked whether it would be easier to use a bilateral approach to NTBs, sector by sector, perhaps along the lines of the Auto Pact. In response, one panel member stated his belief that the GATT has to deal with the issue of how to develop a system or set of rules and procedures that is consistent with an open, liberal trading system and allows the development of new industries. He noted that in the past, most protection has been given to old industries, while the emphasis has now shifted to protecting new industries. He also cited the need for the development of some kind of coordination system but contended that this development should not be done bilaterally because that would result in trade diversion, not trade creation. Developing a coordination system would therefore require that all the major countries negotiate simultaneously.



One final comment was directed at remarks made during the symposium on the Lavelle-White report. It was suggested that as an alternative to the recommendations of this report, the Auto Pact be enlarged to include Japan, with the possibility of exporting a U.S.–Canadian-made car to Japan provided there is a quid pro quo on Canadian and U.S. content for Japanese investment. The responding panelist could not imagine extending the Auto Pact to Japan because the United States would not agree to it and the GATT would not grant a waiver.

## *Data*

Two points were made about the process of investigating NTBs in Canada. First, it was suggested that Canada look at the example of the Industries Assistance Commission in Australia. This commission regularly publishes estimates of assistance for various industries. Second, in reference to the Textile and Clothing Board and the Anti-Dumping Tribunal, it was suggested that the amount of information going to policy makers is often incomplete.

Several other comments were made on the difficulties of gathering and interpreting data on NTBs. On the issue of interpretation, one participant cited evidence that despite general belief to the contrary, some NTBs, such as the Multi-Fibre Arrangement, work in favour of the restricted country. This occurs because the increased profits associated with the trade restriction are transferred to the exporting country under some trade restrictions.

In summary, it was apparent during the discussion that the central issue was the increased use of NTBs and the question of whether negotiating on them bilaterally is the best option for Canada. There seemed to be general agreement that the use of some types of NTBs is on the increase. However, there was no consensus on how to deal with these barriers since the discussion confirmed the difficulty of gathering — let alone interpreting — data.

## *Notes*

1. Robert Baldwin, *Beyond the Tokyo Round* (London: Trade Policy Research Centre, 1979), p. 2.
2. Gerard and Victoria Curzon, *Global Assault on Non-Tariff Trade Barriers*, (London: Trade Policy Research Centre, 1972), pp. 1–2.
3. John W. Evans, *The Kennedy Round in American Trade Policy: The Twilight of the GATT?* (Cambridge: Harvard University Press, 1971) p. 88.
4. Information based on Evans (1971), pp. 258–60.
5. General Agreement on Tariffs and Trade, *The Tokyo Round of Multilateral Trade Negotiations* (Geneva: GATT, April, 1979), p. 51.
6. Baldwin (1979), p. 3.
7. Information in this section draws heavily on Department of External Affairs, *A Review of Canadian Trade Policy* (Ottawa: 1983). Section 6. pp. 154–57.

8. The Government of Canada has now agreed to accept the findings of the GATT panel report, including the recommendation that FIRA modify the wording of purchase agreements offered by potential investors to reflect Canada's GATT obligations.
9. Information based on the report of the Standing Senate Committee on Foreign Affairs (*van Roggen Report*) (Ottawa, 1978) vol 2. p. 146.
10. In February 1984, Canada and the United States signed the Canada-U.S. Safeguards Agreement, which provides for more regular consultations in advance of either parties taking safeguard actions that may adversely affect the trade of the other partner.



## Appendix A

### Major Classification Headings in the GATT Inventory of Non-Tariff Measures

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Part I	Government Participation in Trade and Restrictive Practices Tolerated by Governments
A	Subsidies, export subsidies, competitive subsidization
B	Countervailing duties
C	Government procurement
D	Restrictive practices tolerated by governments
E	State-trading, government monopoly practices, etc.
Part II	Customs and Administrative Entry Procedures
A	Anti-dumping duties
B	Valuation
C	Custom classification
D	Consular formalities and documentation
E	Samples
F	Rules of origin
G	Custom formalities
Part III	Technical Barriers to Trade
A	General
B	Technical regulations and standards
C	Testing and certification arrangements
Part IV	Specific Limitations
A	Quantitative restrictions and import licensing
B	Embargoes and other restrictions of similar effect
C	Screen-time quotas and other mixing regulations
D	Exchange control
E	Discrimination resulting from bilateral agreements
F	Discriminatory sourcing
G	Voluntary export restraints and export restrictions
H	Measures to regulate domestic prices
I	Tariff quotas
J	Export taxes
K	Requirements concerning marking, labelling and packaging
L	Others
Part V	Charges on Imports
A	Prior import deposits
B	Surcharges, port taxes, statistical taxes, etc.
C	Discriminatory film taxes, use taxes, etc.
D	Discriminatory credit restrictions
E	Subsidies
F	Emergency action

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*Source:* Unpublished GATT documentation.

## Appendix B

### List of Participants

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RESEARCH SYMPOSIUM ON THE GATT AND  
NON-TARIFF BARRIERS TO TRADE  
AND CANADIAN TRADE POLICY  
HELD BY THE  
ROYAL COMMISSION ON THE ECONOMIC UNION AND  
DEVELOPMENT PROSPECTS FOR CANADA

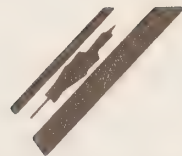
Ottawa, December 2, 1983

Margaret Biggs	North-South Institute, Ottawa
Keith Christie	Department of External Affairs, Ottawa
Peter Cornell	Economic Council of Canada, Ottawa
John Curtis	Institute for Research on Public Policy, Ottawa
Gerald Helleiner	University of Toronto, Toronto
John Higginbotham	Department of External Affairs, Ottawa
James Hyndman	Department of Regional Industrial Expansion, Ottawa
James Markusen	University of Western Ontario, London
Peter Morici	National Planning Association, Washington, D.C.
Andrew Moroz	Institute for Research on Public Policy, Ottawa
W. Douglas Newkirk	Office of the United States Trade Representative, Washington, D.C.
John Quinn	Osgoode Hall Law School, Toronto
Edward Safarian	University of Toronto, Toronto
Gerry Salembier	Institute for Research on Public Policy, Ottawa
Ronald Shearer	University of British Columbia, Vancouver
Frank Stone	Institute for Research on Public Policy, Ottawa
Rodrigue Tremblay	University of Montreal, Montreal
John Weekes	Department of External Affairs, Ottawa
John Whalley	University of Western Ontario, London, and the Royal Com- mission
Bruce Wilkinson	University of Alberta, Edmonton
Peter Williams	GATT Secretariat, Geneva
Gilbert Winham	Dalhousie University, Halifax, and the Royal Commission
Ronald Wonnacott	University of Western Ontario, London

#### From the Royal Commission

Ivan Bernier  
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Colleen Hamilton  
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Alan Nymark  
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## Cartelization and Managed Trade: The Problem of Quantitative Restrictions

WILLIAM DIEBOLD

“Managed trade” is about as much a misnomer as “free trade.” The latter familiar term was all right when it pointed to the link with classical theory. It was natural enough for Bright, Cobden, and the leaders of other nineteenth-century movements to speak these words. But the sophistication of theory made the term less suitable as a recommendation for policy because it became clear that the best results of free trade could only be expected in conditions that rarely pertained in the real world. By the beginning of the modern age of trade liberalization, whether that dates from the passage of the Trade Agreements Act in the United States in June 1934 or from the later negotiations that led to the General Agreement on Tariffs and Trade (GATT), free trade was, quite properly, no longer spoken of as the objective. It would not have been accepted by responsible governments, although it was possible to get general support for reducing the barriers to trade that had been set up during the Depression and World War II. Much later, when it was no longer unthinkable that the remaining tariffs might be eliminated or disregarded — say, by the end of the Kennedy Round — it was plain that tariff-free trade and free trade were not the same thing. Nevertheless, and rather insidiously, there has been a marked rise in the use of the term “free trade,” as if it were a guiding light, in summit communiqués, in newspaper articles, and in what ought to be better-informed writing as well. As no government is really dedicated to free trade and few individuals I know of would advocate it without qualification, this practice is either ignorant or intellectually dishonest, and in either case it is politically unwise. Of course we need shorthand but there are plenty of acceptable terms in use, such as “liberalization,” “open trading system,” or simply “freer trade.”<sup>1</sup>

With a shorter history, “managed trade” ought to be quite clear, but is it? Without digging into any records, I share the general belief that the term originated in French use during the last 15 or 20 years. (“Organized trade” is another version.) It was undoubtedly intended to suggest measures that would avoid the “cut-throat competition” that French (and sometimes other) businessmen have long associated with the kind of trade liberalization advocated by “Anglo-Saxons.”<sup>2</sup> What is not so clear to me is whether “managed trade” was meant to be a general objective — a condition that ought to prevail in most international trade — or whether it was to apply to certain cases that were especially important or difficult, economically or politically, or whether it was primarily a formula to cover the arrangements during a transitional period when adjustments were being made to the removal of old trade barriers.

Plainly, the term is meant to be soothing, suggesting that everything is under control and will be well handled. “Management,” after all, is a good word in most modern parlance, whether the emphasis is on dealing with crises or the supposed science of running businesses. “We’ll manage” is an expression of assurance, not a plea for help. Still, it is impossible to escape the impression that “managed trade” is often a euphemism for protection or at least the minimal disturbance of the status quo. My earlier reference to it as a misnomer concerned not these ambiguities but doubt about how often one is likely to find a significant segment of international trade that can be effectively managed, if that means shaped, controlled, and guided so as to serve an agreed and specified purpose. One’s doubts may be based on the weaknesses of forecasting, the flexibility of economic processes, and the perverse reactions they can produce, as analyzed so well in Robert Baldwin’s Graham Lecture on “The Inefficacy of Trade Policy,”<sup>3</sup> or simply the instability of complex arrangements based on the interplay of conflicting interest in fields where, almost by definition, significant forces for change are at work.

It would not be useful to carry this kind of argument or speculation much further. We certainly cannot dismiss the subject on the ground that it might produce only imperfectly managed trade. The questions are: Is “managed trade” altogether undesirable or does it have some constructive uses? In either case, what should be done about it?

## **Types of Managed Trade**

There are at least three ways in which significant segments of international trade might be managed — by the enterprises involved, by a single national government, or by two or more governments working together. The first two I shall leave aside with just a word about each.



It was natural, when plans were being drawn up for postwar trade liberalization, to try to make sure that when official restraints were removed they would not be replaced by private trade barriers. Not to worry about cartels and large concentrations of private economic power would have been to disregard history.<sup>4</sup> No very promising international measures were put into effect, but the problem has not appeared to be very serious in the postwar world. Why this is so, and whether more attention should now be given to global oligopoly or international agreements on technology, are questions beyond this paper. So, too, is consideration of the not-altogether-alien concern about the rising share of international trade that is intracorporate, or among closely affiliated enterprises. Note, though, that it must be a rare case when even the most powerful multinational enterprise can ignore the sovereigns of the territories in which it operates or swallow all the costs their barriers or regulations may impose. Perhaps the roster of examples of managed trade should include the results of arrangements between such enterprises and some governments as to exports, local procurement, what activities will be carried on inside each country, and related matters. It is also important to bear in mind that when governments want to reach agreements about production and trade, it makes a difference if a few firms dominate the market or if there are many relatively small and widely scattered enterprises. Thus there is an overlap with the second and third categories.

National governments acting alone seek in some sense to “manage” trade whenever they try to determine what shall be imported (or exported), in what amounts, at what prices, and under what conditions. We think of this as normal trade policy but when the effort is comprehensive and detailed and fits into a development plan, or is linked with reasonably clear policies concerning certain industries (or possibly areas), one can speak of an effort to manage trade in a fairly meaningful sense. It may be stretching language too far to put in these categories measures against imports that are subject to dumping or foreign subsidies, but there is an element of management in deciding that one kind of trade is fair and another not, and that different rules apply to each. Certainly, when the removal of antidumping or antisubsidy measures results from an agreement about the amounts or prices of goods to be imported, one has to speak of managed trade. This whole terrain is too familiar to need further description. We usually assume that national behaviour in these matters should be subject to some set of international procedural and substantive rules, as is done in the GATT. But when the rules do not work or the procedures are not adhered to, we are plunged into the third category — new kinds of governmental actions to manage trade or to prevent its being managed.

Although the main purpose of the GATT is trade liberalization, it also provides for the control of trade, so the profile of “managed trade” is not

sharp and clear. It will save time, though, if we concentrate first on departures from the central thrust of the GATT and later on possible new kinds of action.<sup>5</sup>

## The Experience with Managed Trade

From the outset, one kind of managed trade — commodity agreements — was recognized as falling outside the regular GATT rules. These have been of limited significance in the postwar period. Some of the experience tends to support the view that “management” of this sort does not long endure. (OPEC is another matter — and another kind of commodity agreement — and does not come up here.) In the U.S. State Department in the late 1940s, we defined a commodity agreement as a cartel approved by the Department of Agriculture. But as it turned out, the agricultural issue cut deeper in another direction. The American waiver of 1955, and the action of other countries without a waiver, reflected the incompatibility of the most widely accepted farm policies of industrial countries with the GATT trade rules. The result was not managed trade in farm products. There have been bits and pieces of agreement on particular markets but no serious effort to produce a more general structure. What we have instead is a series of managed domestic agricultures and disorganized international trade.

The next big segment of trade to be carved out of the GATT was the cotton textile industry (and it was only a matter of time and diplomacy until man-made fibres and woolens followed). In contrast to the situation in agriculture, complex new trade rules were made and a procedure was set up that, although it permitted a degree of multilateral surveillance, rested basically on negotiations between exporting and importing governments (each of which might have whatever relationship it wished with its “own” industry). Some of the negotiations led to extraordinarily detailed arrangements; their conclusion was assured because the importer could always, in the end, impose import restrictions according to certain rules. This is certainly managed trade or at least an arrangement within which much of the international trade in textiles and clothing could be managed — and mostly by the rich countries with the largest markets.

It was never altogether clear what the management of the textile trade was supposed to produce. Protection was the initial motivation of the United States and the other industrial countries. However, restriction of imports of one product led to the expansion of imports of another; cheap pants gave way to more costly ones when the limit was stated in pairs. The impact on producers in North America and Western Europe was often different from what was expected. Textile trade grew substantially, though probably not as much as it would have without the agreement and if normal GATT rules had been adhered to. But what reason is there to



suppose that importing governments would have adhered to those rules or only imposed such restrictions as would be permitted by a strict interpretation of Article XIX?

Besides protection, there was at least the ghost of an idea that the arrangement would provide for the “orderly transfer” of those parts of the textile industry best suited to low wage countries. Some transfer has certainly taken place but the process has not been especially orderly, even if it has been slower than otherwise. New textile exporting nations emerged at least in part because they could count on markets in the industrial countries until their shipments became big enough to trigger a reaction. Japan, Hong Kong, South Korea, and other countries expanded exports of other products when their textiles hit the ceilings imposed in Europe and North America. Markets developed in export quotas, and producers in the old centres found they had competition in expensive, high-quality products as well as cheap goods. The nationality of producers became obscured as Japanese and Hong Kong firms acquired a stake in the output of other exporting countries, and American importers financed such activities as well.

Producers in the importing countries continue to complain about competition, and restraints have been tightened. Some would apply the same controls to imports from other industrial countries as apply to Japan and developing countries. Some exporting countries like having sheltered markets as cheaper producers come up behind them. Jobs have been saved in the old centres of production in North America and Europe, but the protection has also permitted a good deal of reorganization and new investment that appears to have produced some highly competitive firms (although perhaps not in the clothing industry). But who has brought into focus a clarification of the whole process, of its costs, and who paid them?<sup>6</sup> Does anyone wish to replicate the model in other industries? I have found that when there is talk of an agreement of some duration in the steel or automobile industries and the response is, “Oh, something like the textile agreement?” then rejection comes quickly. But before we turn to those two other cases of managed trade, let us go back to a more limited form of management that is made use of in the textile arrangements but that preceded them and is still in use in other fields: voluntary export restraints (VERs) and orderly marketing agreements (OMAs).

In the 1950s and 1960s, the United States frequently asked Japan to limit its exports of various products to the United States. American critics were bothered by the fact that this practice had no legal basis and did not require hearings or other public demonstrations of the seriousness of the problems. The informality, however, had the advantage that the restraints could be eliminated more easily than if the United States had imposed import restrictions, and most of the actions were quietly dropped when the immediate pressure was off.<sup>7</sup> Later, OMAs cast

a wider net and were less easily ended before they had run their full term. In accepting Japan in the GATT, European countries frequently put into agreements what had been less formal export restraints. The textile agreements were, in a way, the multilateral institutionalization of these practices.

VERs remain widespread and are almost bound to be an ingredient of any major steps toward managing trade. Consequently, their characteristics ought to be thought out quite systematically and in terms of their economic as well as their political and diplomatic aspects. For example, do they make for cartelization in the exporting country? Is the reward they give exporters, in the form of higher prices, to be seen as a kind of compensation for the restricted market? Should consumers in importing countries be particularly concerned about this practice? The limit on exports permits the producer in the importing country to raise his price without risking loss of market share since "VERs can raise the profit levels of *both* firms in a duopoly at the expense of consumers in the importing country. Tariffs do not generally have this property."<sup>8</sup>

The arrangements for managed trade in steel and automobiles are too well known to need description, but a few observations and questions will help us bring the general policy issues about managed trade into focus.

- As the new, major, and most efficient producer, Japan has challenged one North American and European industry after another. Are there any more old industries as large and basic as textiles, steel, and automobiles that are likely to elicit the same kind of response? The electronics industry was handled differently. Will aircraft and high technology industries also present different problems? If not, is there any way to avoid a series of ventures in managed trade?
- Managing the Japanese part of the "solution" has not given a great deal of trouble. Are Japan's willingness to hold back exports and its apparent ability to begin adjusting capacities in its own basic industries to be explained by good growth rates, a strong balance of trade, systematic differences from the western countries or world politics? Will other Asian countries or newly industrializing countries from other parts of the world be as cooperative?
- The efforts made by authorities in both Europe and the United States to reduce clashes over steel while permitting adjustment to take place in both areas broke down largely under pressure from the American industry, which demanded ever-increasing protection and could invoke fair trade laws that were almost bound to lead to some restrictions, given the nature of the European steel policies. The difficulties of adjustment in Europe contributed to this process, especially since governments took a national rather than a community approach to their problems. Could this breakdown have been avoided by a com-



bined approach to adjustment instead of the unacknowledged parallel action that was attempted?

- In automobiles, the American proposal for Japanese VETs was intended to be temporary while adjustments took place in the United States. In a classical manner, the process stretched out but the need for annual action gave the U.S. government some leverage over the industry's performance (including wages and bonuses). How much use may be made of this possibility is another matter. In Europe, limits on Japanese automobiles seem to have no function other than holding down imports.
- The supposed American preference for letting market forces produce adjustment is presumably at work in the steel and automobile industries, but it has taken a long time and has put heavy burdens on American consumers and very likely on other parts of the economy. It has been challenged both by the industries in question, so far as market forces include imports, and by people outside the industries because when it took the form of companies diversifying their activities and investing in other lines, the question arose of who was looking after the national interest in the industry as a whole. It has kept the government from doing things over a rather long period that might have been useful. And it has made it hard for the government to act until a difficult late stage when much pressure had built up.
- The use of limited measures of managed trade in the automobile and steel industries has raised further questions of public policy in the United States — for example, antitrust, foreign investment in the United States, American investments abroad subject to foreign performance requirements, the divergence of interests between the workers and the companies on domestic content, and the financing of steel and automobile facilities in developing countries.
- Managed U.S.–Japanese–European trade has inevitably led to the need to control imports from still other countries, which have had little voice in what was done. It is unclear to what extent any further resolution of issues among the three core units would alter the treatment of these others.
- The issues in Canadian-American relations in both steel and automobiles have not been adequately thrashed out — at least so far as the public knows.
- Although the recession had a key part in bringing on some of the more stringent restrictions and in sharpening disputes, the basic problems in the automobile and steel industries predate the recession. Recovery will alleviate some pressures but will it make for speedier adjustment?

## Basic Policy Issues

The comments and questions on steel and automobiles have carried us toward more general conclusions. As a basis for discussion, I have set down some proposals for the better handling of the issues raised by managed trade.<sup>9</sup>

These recommendations are not intended to produce a series of permanent arrangements for managed trade in major products. A world in which what has been done in agriculture and textiles is multiplied does not seem very attractive, though the existing arrangements in both those fields have their advocates and admirers. Perhaps the textiles agreements and the lack of agreements in agriculture will be with us for some time. Perhaps other special restrictive arrangements may be added if major powers prove unwilling to accept the shrinkage of some industries even when they are not internationally competitive. But these possibilities are not pursued here, nor are ways of mitigating the results by reforming these instruments. My premise is that continued cooperation in trade liberalization should be a major objective, but that it will probably be harder to achieve than in the past and will require innovative methods and an expansion of the scope of what is attempted.

Another premise of these prescriptions is that continuing change in the world economy is the natural order of things; that flexibility and adaptability are major requirements for successful national economies; that competition is the best force for change; and that achieving international competitiveness must be a prime objective of national economic policies. However, efficiency is not the only good that people want, and they are entitled to substitute other things for it if they pay the cost. Many people do not accept these criteria, at least not when the results harm them. Maybe the natural state of man is mercantilistic; the wish to be protected in many ways is strong and widespread. We live in pluralist societies where interests conflict, as also do interpretations of interest. Policy proposals have to take account of these conflicts and of the inherent tension between national governments and an international or global economy. The aim of policy must often be to make change acceptable by controlling its pace and spreading its burdens. Translated into trade policy (often the best shorthand), this calls for a reaffirmation of the principle that it should always be possible to buy time but that there should be better means than we now have of insuring that the time is used well — that is, to foster adjustment.

The GATT should be strengthened. This is partly a matter of applying the existing rules and procedures and enforcing obligations. It is also a matter of enhancing some GATT provisions and adding others. Sometimes the former objective cannot be attained without the latter, and this may take the GATT further into the area of managed trade, however murkily defined. For example, an improved safeguards clause would



permit the management of some countries' imports for a period while adjustments were taking place that would subsequently make the import limitations unnecessary. A prescription for improvement would include tighter standards for invoking safeguards, increased multilateral surveillance during the period they were in force, time limits, and degressive protection. OMAs and VERs would be subjected to comparable rules, so that it would be harder to force them on countries when there were no real problems to be dealt with and exporting countries would be strengthened against importers. Because of the key role of investment both in bringing about structural change in world production and in adapting to it, performance requirements and related matters would have to be brought into the GATT sphere. In all these matters, there would have to be improved means of considering the interests of third parties, of strengthening the defences of weak countries against pressure, and of safeguarding the system as a whole as well as the position of the countries involved in particular transactions or disputes.

Whether through the GATT or otherwise,<sup>10</sup> we should prepare to cope with more problems of adjustment to changes in the structure of the world economy and more pressure for the kind of managed trade or potential cartelization we have been discussing. Maybe future growth and changed national policies will make this unnecessary, but it is preferable to assume the opposite.

Therefore there should be continuing consultation about problems that can be foreseen and prospective policies for dealing with them. From this process, governments should receive early warnings about what others are likely to do and gain a sense of the limits of what will be tolerated in their own behaviour. Under such an arrangement, there would by now have been significant substantive discussions of petrochemicals, of machine tools, and of everyone's favorite objective, the fostering of high technology. It would be best if these discussions could rest in part on wide-ranging studies of the factors making for structural change in the world economy and in specific industries.

As problems of special difficulty are discerned, there would have to be a meeting of minds — or at least of some crucial minds — as to whether the case could best be dealt with by (a) the strict enforcement of existing rules; or by (b) temporarily turning a blind eye to enforcement because the trouble would soon pass and governments must act to ease the immediate pressure (even if retaliation were permitted for the violation of rules); or whether (c) the problems were so large and lasting that new understandings were called for which would amount to a venture into managed trade.

There should be discussions in advance as to what principles ought to guide such ventures. For example, so long as it was making adjustments, a government might be allowed to impose some kinds of trade controls and use some kinds of subsidies (but not others) without being subject to

retaliation by other countries. Equal treatment of all imports and possible departures from that rule would be important issues. If there could be a concentration on results rather than judgment by forms of action alone, that would help bridge differences in national ways of doing things. Transparency would be required and a good bit of international surveillance. There would have to be a forum for complaints, an obligation to respond, relatively speedy settlements of disputes, and a means of insuring the protection of the interests of third countries. It seems unlikely that an early objective ought to be the drawing up of a detailed code covering arrangements for managed trade — the approach to commodity agreements used in the Charter for an International Trade Organization — but that might become a useful focus as experience accumulated (and if there were any successes to copy).

It would also not be the normal aim of these consultations to draw up a tight set of rules for each industry that was to have its trade managed for a period. The risk of doing that would be to create a series of situations such as that found in the textile industry. It would be preferable to handle these problems more loosely, provided that was compatible with getting adherence to the principles and procedures outlined. This may be very difficult, since there is almost always some participant who is in a position to gain by cheating. At bottom, the chances of success depend on there being enough people in enough places who want the benefits of the adjustment that is underway. Fear of retaliation and counter-measures — or even their existence — will play a part. Much will depend on exploiting conflicts of interest within certain countries and showing who the losers are if the adjustment does not take place. In short, the art of managing trade may look quite a lot like managing protection, which is in many ways what trade policy is.

When managed trade is discussed, there is a strong tendency to think in terms of single industries. That is the focus in which problems often arise, or at least are brought to the attention of governments. Frequently, it will seem natural to seek remedies in terms of what is done in a single industry. But there are difficulties: conventional definitions of the boundaries of an industry may be unrealistic, often because they are out-of-date; firms are often active in several industries; adjustment for a national economy may well mean moving resources into other industries; balanced international bargains may be harder to strike within the confines of a single industry than in traditional trade negotiations where a mixed package of products can be dealt with; an industry's problems may lie largely in its relations with the rest of the economy; people within an industry may not be the best judges of their own cause but outsiders may lack technical competence; and so on. No doubt, ways can be found to cope with these difficulties. However, the atmosphere for agreement is not good when, as happens more often than not, the problems we are discussing arise in the first place because major indus-



tries are sick in several major countries. One hesitates to prescribe “managed trade” as a kind of preventive medicine for healthy industries, but to the extent that the procedures discussed here encourage looking ahead and acting on a broad concept of national interest, there may be some useful spillover.<sup>11</sup>

Multilateral agreements of broad scope and the kind of equal treatment expressed by the most-favoured-nation clause should continue to be basic principles of the international trading system. However, to avoid the inaction created by widespread veto powers, especially where complex and novel undertakings are involved, it would be necessary to permit arrangements for managed trade to be worked out, at least initially, by a limited number of countries. Every effort should be made to keep the arrangements consistent with the broad principles and objectives of international trade cooperation and to respect the rights of non-participants. This will not be easy, but neither will any other efforts to deal with these problems.

What is done or not done about managed trade, whether the improved model described here or the more familiar versions of the textile, automobile, and steel industries, will not depend entirely on the merits of the cases or on the wisdom or lack of it shown by governments in these matters alone. The problems that give rise to managed trading arrangements are related to the problems governments try to cope with (or avoid) when they deal with debts, exchange rates, the international monetary system, macroeconomic policies, development financing, technology transfer, export controls, and traditional trade liberalization. It is not necessary to make progress on all fronts at once, but if deterioration is general, there will not be serious prospects for innovation in international economic relations. And without innovation it is hard to see how the deterioration can be stopped.

## Postscript

I was asked two other questions about managed trade: Are quantitative restrictions (QRs) the heart of the problem? And what are the implications of these arrangements for smaller countries such as Canada? There is no room for any but the flattest answers.

QRs do more damage than tariffs, for all the reasons well known to economists and laid out magisterially by Gottfried Haberler in his pamphlet for the League of Nations Secretariat when it was at Princeton during World War II.<sup>12</sup> The reasoning emphasizes adjustment and market forces. Those are also important reasons why businessmen seeking protection and bureaucrats trying to help them prefer QRs. They want to limit competition and pressures for change. They want to keep things under control and believe that this is better done by limiting the amount of imports rather than simply by taxing them. They may often be

mistaken. Robert Baldwin, in the lecture already cited, says that “quantitative restrictions are likely to be less effective in limiting offsetting supply or demand shifts than ad valorem duties.”<sup>13</sup>

Of course, time is a factor. So are the kinds of shifts that are taking place in supply and demand. Suspicion about the other fellow’s ability to manipulate prices or subsidies to offset tariffs is another factor. When the objective is adjustment, the case for tariff-like measures improves, but not if they block acceptance of an arrangement that will make adjustment possible. Attention has to be given to the differences between QRs that are absolute and those that set market shares, and also to the relation of tariffs to other tax or price-raising devices, such as the trigger price mechanism which the United States applied in steel. Nor can fair trade rules be escaped. The subjects are all worth pursuing but I suspect that no amount of demonstration will completely tarnish the appeal of QRs.

As to small countries in general, they have all the familiar problems. They are price takers, not price makers. They also have to accept other aspects of the world as they find it. Interdependence means dependence. Adaptability is a virtue but this may involve adapting to the bad practices of others; the cost of not adapting may be high. If smallness means weakness, then some countries are likely to be put upon by the strong — at least sometimes. There are, however, usually some allies among the people of the strong countries who are motivated either by economic interest or by something broader. Many people who have guided American trade policy since 1934 have had the aim of subjecting the United States to rules and obligations, but in the long run that can only be done if the rules are accepted by other countries as well. When that happens, a system of rules is likely to be of greater value to the weak than to the strong.

## Notes

This paper was prepared for the Research Symposium on Canada and the Future of the Global Trading System, held by the Royal Commission on the Economic Union and Development Prospects for Canada on July 24, 1984. Revisions were added in December 1984.

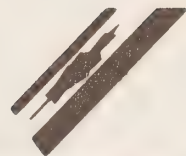
1. More than one person has heard me explain that one of my tasks in the Commercial Policy Division of the U.S. State Department in the mid-1940s was to go over the material produced in the Public Affairs Division to be sure it conformed to policy. Adding the *r* was the most efficient way of avoiding a major error.
2. The British publicist William D. Clark once asked, “Why are the Americans always called Saxons?”
3. Robert Baldwin, “The Inefficacy of Trade Policy,” *Essays in International Finance* 150 (Princeton: Princeton University, Department of Economics, International Finance Section, 1982).



4. "Private" was the governing word in those days. Now it is best to include state-owned enterprises, at least insofar as they act mainly in a commercial way and are not strong enough individually to dominate the whole process, in which event the case falls into the second category.
5. This is not a legal or technical discussion, so words like "departure" and "central thrust" are used somewhat loosely; indeed, even "GATT" should be taken as a kind of shorthand for the whole process of trade liberalization.
6. This is not the place to analyze the studies that have been made bearing on these issues. My somewhat impressionistic text draws on my memory of these studies and my observation of the textiles arrangements which began with an inside look at some of the first negotiations. The latest study by the GATT Secretariat reached me after this paper was written. It argues that textiles and clothing should no longer be regarded as a "special case." Instead, "trade policy officials face essentially the same general issues in dealing with textiles and clothing as they do in dealing with several other tradeable goods industries. The solutions to these problems lie at the general trade policy level." General Agreement on Tariffs and Trade, "Textiles and Clothing in the World Economy" (Geneva, July 1984), p. 11, mimeographed.
7. See the discussion in Warren Hunsberger, *Japan and the United States in World Trade* (New York: Harper and Row for the Council on Foreign Relations, 1984), pp. 234–39.
8. G.M. Grossman and J.D. Richardson, *Strategic U.S. Trade Policy: A Survey of Issues and Early Analysis*, NBER Research Progress Report (Cambridge, Mass.: National Bureau of Economic Research, 1984), p. 18.
9. This section draws heavily on Miriam Camps and William Diebold, *The New Multilateralism: Can the World Trading System Be Saved?* (New York: Council on Foreign Relations, 1983), but Mrs. Camps is not responsible for my formulations in this place. Some of the ideas are discussed more fully there and, in a different context, in William Diebold, *Industrial Policy as an International Issue* (New York: McGraw-Hill for the Council on Foreign Relations, 1980).
10. There is a school of thought which says that it would be unwise to bring into the GATT issues that cannot be dealt with adequately under tight rules and procedures and that are likely to be "politicized" in key countries. Some people would even go so far as to say that the GATT is better off because the steel and automobile issues have been handled elsewhere. I do not agree with either of these views. What weakens the GATT and adds to its erosion is the inability to deal with these difficult problems because of the unwillingness of governments to deal with them along such lines. There may be good reasons for conducting some of the discussions and negotiations recommended here in different places but that can be done in ways that do not weaken the GATT.
11. The idea is not entirely new. Before the end of the Kennedy Round, Sir Eric Wyndham White suggested that it might be useful to establish free trade in a few modern, international industries that used high technology and had relatively few large producers. The idea was never tried but it seems likely that it would have involved, at least for a time, some of the restraints, toleration, and other behaviour suggested here as elements of "managed trade." See William Diebold, *The United States and the Industrial World* (New York: Praeger for the Council on Foreign Relations, 1972), pp. 140–44. Problems of the sectoral approach are also discussed there and in Chapter 4 of Diebold, *Industrial Policy as an International Issue*.
12. See Gottfried Haberler, in collaboration with Martin Hill, *Quantitative Trade Controls: Their Cause and Nature* (Princeton, N.J.: League of Nations, 1943).
13. Baldwin, "Inefficacy of Trade Policy," p. 5.







## The Developing Countries in the International Trading System

MARGARET BIGGS

In recent years, the developing countries (DCs) have become some of the staunchest defenders of the “old trading order” — the multilateral, non-discriminatory, rule-based trading system rooted in the General Agreement on Tariffs and Trade (GATT). They have persistently pressed at every major international meeting for a standstill on protectionism and for further liberalization of trade. Yet the developing countries have been the strongest opponents of current proposals to undertake a new GATT round of trade liberalization. This paper will endeavour to explain the reasons behind this apparent contradiction.

The discussion will begin with a brief outline of the developing countries’ roles and interests in the GATT up to the present. Then the DCs’ stake in a new GATT round will be discussed, particularly the agenda items which are likely to be of greatest consequence for them. Finally Canada’s potential role in dealing with these issues will be explored, especially areas of potential common interest and mutual concern with the developing countries.

Before proceeding, it is important to note that considerable differences exist among the developing countries in terms of their economic size, structure and dynamism, and their involvement in international trade. Developing country participation in the GATT is not uniform. Only a relatively small number of DCs play a very active role, and it is often difficult for a common “group” position to emerge. Particularly telling is the fact that eight newly industrializing countries (NICs)<sup>1</sup> accounted for approximately 80 percent of the developing world’s total manufactured exports in the 1970s and 80 percent of the growth in the DCs’ exports of manufactures as well.

Yet it would be wrong to assume that only a handful or two of middle income DCs in Asia and Latin America have a position on and stake in GATT issues, or that the NICs' interests are qualitatively different from those of most other developing countries. In general, developing countries share a common perception that as emerging nations in the postwar and postcolonial era they have had little influence on the evolution of the international trading system and have not shared equally in its benefits. Moreover, the goal of upgrading, diversifying and expanding semi-manufactured and manufactured exports is nearly universal in the developing world, and virtually all DCs are concerned about questions of market access and protectionism. Indeed, in some ways it is the "near-NICs" and the "aspiring NICs" who have been most threatened by the proliferation of protectionist measures. Not having as much economic flexibility and diversity as the NICs, they are not as able to manoeuvre around protectionist barriers. Many investors and policy makers in these countries are reconsidering their outward-oriented policies in the light of continued protectionist pressures in the developed market economies (DMEs).

It is also important to note at the outset that the developing countries are now of considerable consequence in the world economy. One reason is the pressing immediate concern about severe balance-of-payments and debt-servicing problems in many developing countries and the need to maintain open markets for their exports to avoid the risk of heightening their financial crises. Second, the DCs have become major trade partners for the developed economies. For example, close to 25 percent of exports from the DMEs go to developing countries, and for some countries such as Japan and the United States this figure is much higher (45 and 35 percent, respectively). More important, developing country markets have been the fastest growing markets for the DMEs. For example, they have been credited with "most of the growth in American exports from 1975 to 1980 and thus with a significant share of the new jobs created in the United States in manufacturing firms during this period."<sup>2</sup> As for Canada, our trade with developing countries is relatively small by OECD norms (only 12 percent of exports), due to the weight of the United States in our overall trade relations. But as Table 5-1 indicates, the DCs have been our fastest growing trade partners and have taken up much of the slack in our waning trade with Western Europe.

## **To the Present: The Developing Countries and the GATT**

Although the developing countries have benefitted from the gains made in successive multilateral trade negotiations and the growth in world trade which these negotiations fostered, the DCs in general have been



**TABLE 5-1 Changing Patterns of Canadian Trade**

	Share of Total Exports		Growth <sup>a</sup> of Export Share 1970-80	Share of Total Imports		Growth <sup>a</sup> of Import Share 1970-80
	1970	1980		1970	1980	
	(percent)					
Developing Countries	8.6	12.0	2.79	8.6	13.8	4.59
Asia <sup>b</sup>	2.9	4.1	1.50	2.0	3.2	5.40
Middle East	0.8	1.5	9.62	0.8	4.4	17.94
Latin America	4.5	5.2	1.67	5.0	5.8	1.48
Africa	0.4	1.2	8.85	0.8	0.3	-11.63
Asia-Pacific	0.8	2.1	9.25	1.5	2.8	7.40
Developed Countries	90.3	85.1	-0.45	90.6	85.8	-0.47
Western Europe	18.6	14.9	-3.12	14.0	10.1	-3.43
Japan	4.9	5.9	1.82	4.2	4.0	-2.43
United States	64.7	63.1	0.02	71.1	70.2	0.14
	(current \$ millions)					
Total Trade	16,491.1	74,446.0		13,951.9	69,273.8	

Source: North-South Institute, *Canadian Trade with the Asia-Pacific Developing Countries*, Briefing 8 (Ottawa: North-South Institute, September 1983) p. 4.

a. Average annual growth rate based on least-squares estimations.

b. Includes Asia-Pacific developing countries.

less than satisfied with the GATT's ability to serve their interests. For example, the developing countries were disappointed with the results of the Tokyo Round of negotiations. (This disappointment was heightened by the fact that the interests of the developing world had been established as a key issue for the talks by the Tokyo Declaration in 1973.) Tariff reductions of the developed market economies on products of interest to the developing countries were not on a par with the average or formula cuts; in some products of prime export interest to the DCs, such as certain apparel items, no tariff reductions were achieved. This pattern was consistent with the results of earlier multilateral negotiations and is a natural outcome of reciprocal negotiations among the DMEs.

Particularly disappointing for the developing countries was the failure of the Tokyo Round to strengthen Article XIX, the safeguard code, and the drift toward acceptance of "selective" safeguards, a major break from the GATT's first principle of non-discriminatory or most-favoured-nation (MFN) treatment. In the latter stages of the negotiations, the developing countries provided the main resistance to pressures from the DMEs (primarily European) for "selectivity," recognizing that as small, new suppliers they stood to be prime victims of any sanctioning of discriminatory trade measures.

The safeguard issue, the non-MFN application of the new codes on non-tariff measures in the Tokyo Round, and the intensification of restrictive trade measures which occurred in the early 1980s appear to have heightened the recognition by the developing countries that they

stood to lose more by the proliferation of *negative* discriminatory actions against them than they could gain by the pursuit of special *positive* preferences. Hence, while the DCs are still concerned with preserving in principle and putting into practice the concept of special and differential treatment, they have assigned higher priority to attacking protectionism and defending the multilateral trading order. They now realize that it is in their interest to protect the rule-based trading order of the GATT and its basic principles of most-favoured-nation treatment, predictability and transparency.<sup>3</sup>

This defence of the “old order” is in striking contrast to the effort to create a “new international economic order” which the developing countries’ disaffection with the GATT had helped to foster in the 1960s and 1970s. However, their underlying skepticism about the structure of international trade relations and reticence to buy too fully into the existing system still exist. One expert observer described this reticence as the “real heart of the North-South problem in the GATT” and observed that “since the two giants seem to set the rules and decide when they are to be applied, and how, it is not surprising that other nations feel uncomfortable about giving up their own freedom of action.”<sup>4</sup>

## **The Future: The Developing Countries and a New GATT Round**

The developing countries have shown little enthusiasm toward current proposals for a new round of multilateral trade negotiations. However, their reticence and, in some cases, outright hostility toward the proposals do not mean that they oppose a new global drive to liberalize trade. Rather, they are concerned about the “when,” “what” and “how” aspects of the recent proposals.

First, they fear that the proposal for a new round will supplant the existing post-1982 Ministerial Work Program of the GATT, which contains many major items of “unfinished business” from the Tokyo Round that are of concern to the developing countries. Inasmuch as any new round is expected to extend GATT activities and negotiations into new areas, the developing countries are concerned about overloading the system. More particularly, they are concerned that attention will be diverted away from the difficult, unresolved issues of safeguards, agricultural trade, and trade in textiles and clothing, or that new issues will be drawn into negotiations on existing agenda items (such as market access in services in exchange for market access for labour-intensive manufactures).

In general the developing countries do not yet feel that there is much in the proposed new round for them; they can see little to gain and much to lose. In particular, they do not see much evidence that the new round will result in checks in DME protectionism, particularly discriminatory pro-



tectionism, against key DC manufactured exports. Earlier U.S. proposals for a "North-South trade round," which centred around the developed market economies extending further benefits under the Generalized System of Preferences in exchange for trade concessions by the developing countries, have made the developing countries skeptical about whether there would be an adequate quid pro quo for their participation in any new round.

Finally, on a political level, the developing countries appear to be waiting until the proposal for new trade talks takes on a more multilateral character. They do not want to appear too willing to embrace a proposal whose major sponsors are DMEs, especially the United States, until such time as a broader group of countries have the opportunity to contribute to its formulation. Hence, positive DC input into discussion of a new trade round is unlikely at least until the November 1984 GATT session and probably until some time into 1985.

### *Unfinished Business on the GATT Agenda*

Of the items which remain on the GATT agenda and which will hopefully be resolved before or at the outset of any new trade round, the safeguards issue, including the question of safeguards in international textiles and clothing trade, remains of greatest importance to the developing countries. Indeed the broader question of whether and how trade will be "managed" in industries other than just textiles and clothing, in which the DMEs encounter widespread and troublesome problems of structural adjustment, is of considerable consequence for the DCs.

The Multi-Fibre Arrangement governing global textiles trade has taught the DCs the dangers of accepting a system of sectoral managed trade which singles out new, low-cost suppliers as the source of market disruption, and which sanctions selective, bilaterally negotiated trade restrictions to curtail "disruptive" suppliers. They believe that such systems tend to move in the direction of greater restrictiveness, contrary to their original intention of facilitating structural adjustment, and that often unrestrained (i.e., DME) suppliers are able to enhance their market position while restrained DC suppliers are held in check. In the long run they believe that under such a system their export promotion prospects will be foreclosed and "latecomer" DC suppliers in particular will be unable to obtain significant market shares and sufficient export growth.

Not surprisingly, the experience with the Multi-Fibre Arrangement has made the developing countries wary of any kind of selective safeguards and of and of sector-specific schemes to "manage" international trade and structural adjustment. They believe that selective restrictions, which would inevitably be directed primarily at new market entrants, would serve to undermine their industrialization and export efforts and deny them the opportunity to exploit their dynamic comparative advan-

tage fully in international trade. They are also skeptical that new rules governing safeguard actions (such as multilateral surveillance, standardized criteria, degressivity<sup>5</sup> and time limits) would on their own be sufficient to police such actions. They question the ability of governments to withstand domestic pressures for selective actions in the absence of strong countervailing pressures from major external trade partners.

For similar reasons, "managed" trade in textiles and clothing has also led the developing countries to question the wisdom of "sectoral solutions" to structural adjustment problems. They doubt whether economic efficiency concerns can ever be adequately addressed in the context of sector-specific discussions when successful adjustment often requires inter-industry adjustment and when there is such close interaction between industry lobbies and national administrations.

There is no doubt that adjusting to new competition from developing countries is one of the major structural adjustment challenges facing the developed market economies for the foreseeable future and that better ways to manage and facilitate structural change in the world economy must be found. In this regard, the developing countries have decided that their interests can be best protected by going back to the first principles of the GATT. Hence they favour phasing out the Multi-Fibre Arrangement and bringing textiles and clothing trade under the general discipline of the GATT at the same time as most-favoured-nation treatment is preserved in the safeguard code.

### *Proposed New Agenda Items*

Of the new items which have been proposed for a new GATT round, trade in services and trade-related investment issues affect the developing countries most directly. Indeed, the developing countries believe they are one of the major targets for this initiative and many of them have strongly resisted efforts to introduce these issues into the GATT. (It should be noted that the DCs have not formulated a common position on the services issue and that some DCs are more opposed than others.) As noted previously, a general concern of the developing world is that the services issue will supplant "unfinished business" on goods trade or that market access in the service area will be traded off against market access in manufactures.

More specifically, however, the DCs are concerned about the content of the service trade proposal, particularly what is included and what is not, the underlying institutional questions, and how liberalization in the service area might affect their sovereignty and development strategies. On the latter point, as emerging nations, the DCs do not want to relinquish any control over their economic and political sovereignty and development and thus are concerned about having to negotiate foreign



participation in such key sectors as banking and finance, transportation, and communications. They are also concerned that the services proposal, as it has been discussed to date, seeks to liberalize the movement of capital but not labour although the export of labour has become an important source of foreign exchange for many DCs, just as income from foreign investment is for many DMEs. Similarly, the developing countries feel that trade-related investment issues are being broached too narrowly and that the concerns of host countries regarding the accountability of foreign firms and such matters as transfer pricing should be included. This issue in particular has underscored the resistance of many DCs to introducing the investment issue into the GATT at all and their preference that the issue continue to be dealt with in the UN Conferences on Trade and Development and in the context of the UN code on transnational corporations.

Another issue which is being given new impetus and attention in proposals for a new trade round, although it is not “new” in itself, is the question of “graduation” and reciprocity on the part of the developing countries, particularly the newly industrializing countries. In general, the advanced developing countries are not opposed to liberalizing of their import regimes; many of them have been moving in this direction on their own accord for some time. However, as mentioned earlier, they are concerned about the *quid pro quo* for any “North-South” negotiations of this kind and are worried about restricting their freedom of action.

At the same time, the merits of further liberalization in the developing countries must now be considered in the context of the serious financial crises and balance-of-payments disequilibria which plague many of these countries. Under present circumstances,

a lowering of import restrictions and elimination of export subsidies by LDCs [less developed countries] to accommodate demands from some industrialized countries are likely to lead to further balance of payments troubles and a decline in LDC economic activity. Thus, such actions are more likely to lead to a decline than an expansion in LDC imports from the North. The most effective means of expanding northern exports to the South is now, as it has always been, for the North to import more goods from the South.<sup>6</sup>

## Canadian Roles and Interests

On a domestic level, there are many elements of Canadian trade policy in which it is apparent that certain Canadian interests and developing country interests are in conflict. The primary examples include a tariff structure weighted against labour-intensive manufactures and many processed raw materials, a longstanding and extensive system of bilat-

eral restraints against DC textile and clothing exports, and continued special restraint measures on footwear imports. Even Canada's new special import policy legislation governing such matters as dumping and subsidies poses a number of special hazards for the developing countries. For example, the developing countries, as new market entrants with many non-price disadvantages, often have to differentiate themselves by offering lower prices and can thus run afoul of anti-dumping procedures. More generally, the uncertainty, complexity and expense involved in such measures of "contingent protectionism" are particularly troublesome for small and new suppliers.

Although the interests of Canada and the developing countries often appear to diverge in practice at the level of domestic policy, they do converge at the broad international level. It may be trite, but it remains true and bears repeating, that the developing countries and small DMEs such as Canada share a strong common interest in a healthy and orderly world trade system and that they stand to lose the most from the erosion of the rule-based, non-discriminatory GATT trading order. Inasmuch as the greatest threat to this order is the drift toward bilateralism and dilution of the unconditional most-favoured-nation principle, Canada should join the developing countries in opposing selective safeguards, non-MFN application of the Tokyo Round codes, and the extension of the Multi-Fibre Arrangement. To its credit, Canada has played a role in helping to strengthen the GATT's dispute settlement procedures, an initiative which makes the GATT more of a rules-based system and should be continued. Finally, the interests of Canada and the developing countries have explicitly converged on the trade-related investment issue. As "host countries," both the developing countries and Canada wish to ensure "a balanced consideration of the investment and right to establishment question."<sup>7</sup>

## Notes

This paper was prepared for the Research Symposium on Canada and the Future of the Global Trading System, held by the Royal Commission on the Economic Union and Development Prospects for Canada on July 24, 1984. Revisions were added in December 1984. The views expressed are those of the author and not necessarily those of the North-South Institute directors or supporters.

1. The term "newly industrializing country" (NIC) is used in this paper to describe an exceptional group of developing countries that experienced rapid industrial transformation and export growth and significant export levels during the 1960s and 1970s (e.g., Hong Kong, South Korea, Taiwan, Singapore, and Brazil). The term "near-NIC" refers to a small group of developing countries which achieved export growth rates in the 1970s approximating those of the NICs but which do not yet have the advanced level of industrial capacity and exports characterized by the NICs. The core of this group is comprised of the Southeast Asian countries of Malaysia, Thailand and the Philippines. Close on the heels of the "near-NICs" are the "aspiring-NICs" — countries like Sri Lanka and Indonesia — that are at an even earlier stage of industrial and export transformation but have already achieved fast export growth in a small range of manufactured products.



2. George Schultz, U.S. Secretary of State, "U.S. Emphasizes Mutual North-South Interests," speech to the Foreign Policy Association in New York on May 26, 1983.
3. Transparency refers to the visibility of a trade measure and the ability of trade partners to scrutinize it.
4. Harald Malmgren, "Threats to the Multilateral System," in *Trade Policy in the 1980s*, edited by William R. Cline, (Washington: Institute for International Economics, 1983), chap. 6.
5. Degressivity refers to the scheduled phasing down and out of an emergency trade restriction.
6. Carlos F. Diaz-Alejandro, and Gerald K. Helleiner, *Handmaiden in Distress: World Trade in the 1980s* (Ottawa: North-South Institute, 1982), p. 13.
7. Canada, *Task Force on Trade in Services: Background Report* (Ottawa: Minister of Supply and Services Canada, 1982), p. 86.







# Underutilized Potential: Canada's Economic Relations with Developing Countries

G.K. HELLEINER

## Introduction

About 70 percent of the world's population lives in the developing countries. Roughly half live in countries with an average GNP per capita of US\$400 or less. Developing countries (or what in recent years has been termed "the South") greatly outnumber the Western industrialized countries ("the North") and the centrally planned economies in international political forums. Their share of world trade is now considerable. Even when oil-exporting countries are excluded, they account for a larger market for Western European manufactured exports than the United States and Japan combined, and they are more important to U.S. manufactures exporters than either Europe or Japan. They are estimated to account for 30 percent of the total growth in world output during the 1970s (Commonwealth Secretariat, 1983, p. 13). Their capacity to service external debt is now universally acknowledged as an important element in the stability of the international financial system.

While it is common practice to discuss North-South relations in a fairly aggregative manner, it is not easy to generalize across the enormous variety of developing countries. India and China, which together account for nearly 40 percent of the Third World's population, have very little in common with Caribbean and Pacific microstates. Korea has little in common with Chad. And Saudi Arabia, Kuwait and the United Arab Emirates are almost unique in their relationship to the world economy. Clearly, the specific interests of individual developing countries differ greatly. Yet these countries have been allied, at least in certain essential objectives, at the international level and they remain united in their

perception that from their perspective the present international economic order does not function nearly as well as it might.<sup>1</sup>

The interdependence of national economies is now much greater than at any time since World War II. The role of the developing countries as a group in the functioning of the global economy cannot safely be ignored. Increasingly, the case for Northern concern for developing countries' interests is phrased in terms of mutual interest rather than in the more traditional terms of human solidarity and compassion.<sup>2</sup>

In the smoothly functioning world of many economic theorists, the needs of the developing countries would be met by the normal workings of the market together with such lump-sum transfers ("aid") as are required to achieve an "acceptable" overall distribution of income. Some economists do recommend, in essence, just such a "solution" — free trade plus greater aid. If these policies are feasible, there is much to be said for them.<sup>3</sup> In the real world of market imperfections, instabilities, self-interested governmental interferences and wholly inadequate aid mechanisms, however, matters are often more complex. In recent years, at a time when the industrialized countries have appeared to take less interest than before in the developing countries, North-South economic relations have entered a phase of "interlinked deterioration" in which they risk a continuing path of "mutual injury" (Lewis, 1982).

Apart from the obvious humanitarian interest in overcoming the absolute poverty within which about one billion fellow human beings continue to exist — and for many Canadians that is the bottom line — there are self-interested grounds for Northern encouragement of Southern development efforts. In terms of global "frontiers," underexploited resources and opportunities, the developing countries undoubtedly offer the greatest potential for generating previously unrealised income. Not only are their physical resources underexplored and underdeveloped, but their human potential has also scarcely begun to be tapped. Ninety percent of the world's births now take place in the Third World and only a minority of those who attain maturity will have formal schooling beyond the primary level. The entire world is likely to gain materially from development of the productive potential of this huge population.

There is also a clear Northern interest in reducing the rate of global population growth and preventing further environmental pollution and degradation. To a substantial extent, the fertility rate is related to developmental variables such as income levels, urbanization, female participation in the workforce, and education. A necessary condition for the eventual stabilization of global population is the achievement of certain basic and stable standards of living in the developing countries. At the same time, the environmental effects of overharvesting forests, overgrazing the land, and polluting air and water cannot be confined to the Third World, although that is where the pressures to degrade the environment in these ways are greatest. It may also be increasingly difficult



to maintain overall political stability in a world in which large numbers of people live in absolute poverty while a minority becomes ever more wealthy. One need not conjure up Heilbroner's (1974) horrific visions of nuclear rockets being rained on Northern cities by desperate Southern leaders or terrorists in order to see an emerging political problem: it is the same "problem" that has produced the welfare state in the democratic West.

There is clearly a Northern interest in international order. Political order is difficult to ensure and its determinants are complex. One of the influences upon it, however, is certainly international *economic* order. Order and predictability in the international economy are of course desirable ends in themselves. Those economies that are especially dependent upon international exchange are most affected by international events, and therefore their governments should be most interested in the stability and growth of the global economy. These include the smaller industrialized countries and the vast majority of developing countries. Trade-dependent countries like Canada thus have good reason to go further than the Great Powers, toward accommodating the developing countries in the international economy, both to forestall any disorder that may arise directly or indirectly from developing countries' disaffection with the international status quo, and to join them in seeking a more stable and productive international economic system.

It was undoubtedly such factors as these that led Prime Minister Trudeau<sup>4</sup> to declare in a much acclaimed speech in London in 1975:

The demands of developing countries have been carefully formulated and powerfully articulated. They reflect a sense of frustration and anger. Those countries seek no piecemeal adjustments but a comprehensive restructuring of all the components — fiscal, monetary, trade, transport and investment. The response of the industrialized countries can be no less well-prepared and no less comprehensive in scope. But we should be very wrong, and doing ourselves and our children a great disservice, if we regarded this process as an adversary one. We would be foolish as well, for solutions are not beyond our reach.

But Canadian policy has not lived up to this admirable rhetoric. The Government of Canada has not as yet distinguished itself in the search for these solutions. Nor is it obvious that it would have carried the necessary public support if it had. As Wood (1982, p. 94) observes:<sup>5</sup>

More than most of the industrialized nations, Canada is visibly torn between its interests in the global *status quo* and in a basic re-ordering of the international economic system. Even the country's international "identity" has sometimes seemed to be at issue in the major North-South debates of recent years.

# The Developing Countries in the International Economy

## Overall Perspectives

Although Northern perceptions and public attitudes toward the developing countries have tended to centre upon the aid relationship, the developing countries as a group have not placed aid issues in the forefront of their concerns for the last two decades or more. There are still developing countries that depend heavily upon foreign assistance for the financing of investment and imports; some low-income countries are in fact more dependent upon aid today than they were in earlier periods. In the aggregate, however, North-South interaction is dominated by commercial relationships. The value of trade flows and commercial capital flows dwarfs the importance of foreign aid in all but exceptional developing countries. Using balance of payments data and terminology of the International Monetary Fund, "official transfers" to non-oil developing countries totalled only 11.7 billion SDRs<sup>6</sup> in 1982, while their total exports of goods and services were nearly 400 billion SDRs (see Table 6-1).

Developing countries, therefore, have understandably sought reforms in the trading arena, as well as in the realm of international finance, for many years. "Trade, not aid" was a developing country slogan of the 1960s. In the 1970s, following the breakdown of the Bretton Woods exchange rate regime and the first oil-price shock, these countries pushed actively for a "new international economic order" (Helleiner, 1976). This proposed new order was primarily an amalgam of proposals for international economic reform that had been developed and presented over the course of the previous decade. In 1975 the United

**TABLE 6-1 Major Elements in the Aggregate Balance of Payments of the Non-Oil Developing Countries**

	1982
	(billions of SDRs)
Current Account	
Merchandise exports	295.7
Other goods and services exports	103.7
Subtotal	399.4
Merchandise imports	-340.0
Other goods and services imports	-154.6
Subtotal	-494.6
Capital Account	
Private transfers	21.4
Official transfers	11.7
Direct investment	10.7
Portfolio investment	5.3
Other long-term capital inflow	35.6

Source: International Monetary Fund, *IMF Survey* (January 9, 1984), p. 13.



Nations formally adopted, by consensus, a resolution (No. 3362, Seventh Special Session) favouring moves towards its implementation, but there was never much expectation that the industrialized countries would alter their normal previous practice of case-by-case consideration of specific issues in appropriate international forums (including the IMF and the General Agreement on Tariffs and Trade (GATT)).

A major effort to strike a deal between the OECD, major OPEC countries and the developing countries — through a year-long Conference on International Economic Cooperation, the original “North-South Dialogue” — ended in failure in late 1977. North-South negotiations on a number of issues continued in fairly desultory fashion during the next decade, without a great deal to show for them. Three UN Conferences on Trade and Development seemed to lead nowhere and only engendered more cynicism. Agreement on a Common Fund for commodities — once the centrepiece of the thrust towards a new international economic order — was finally reached, but in a much watered-down version that has still not been ratified by a sufficient number of countries to begin its work.

The Southern diplomatic effort by the end of the decade was directed at a “global round” of negotiations on international economic issues at the United Nations. But continuing disagreement and, in particular, the unwillingness of the industrialized countries to have monetary issues discussed in the UN rather than in the appropriate specialized agencies — the IMF and World Bank, where their control was assured by the weighted voting systems — drove this effort as well into the sand.<sup>7</sup> The second oil shock and the ensuing recession, the worst in its effects upon developing countries since the 1930s, deflected international attention to more immediate crises and away from matters of structural reform. At the same time, however, the experiences of the 1979–83 period dramatically demonstrated some of the systemic weaknesses that the global economy would have to repair, with or without the developing countries.

Northern responses to Southern positions on the need for international economic reform have typically been based upon optimistic assumptions as to the adequacy of existing arrangements and underestimates of the relative importance of the developing countries in the overall scheme of global events. But, as has been seen, these perceptions may be changing. It can be argued that the time is now ripe for systemic rebuilding and reform.

It would be inaccurate and unhelpful to suggest that the problems of the developing countries are exclusively or even primarily attributable to defects in the functioning of the international economy. Internal constraints and domestic governmental policies are typically more important for long-run development prospects in the developing countries than the international reforms for which the Third World presses. (Evidence that these domestic issues are being effectively addressed may

also be an important influence upon the willingness of Northern electorates and governments to provide assistance.) It is nevertheless important for the North to analyse carefully the impact of the international economy upon the South, since that is the prime area in which its own policies and practices impact upon development. It is scarcely within the North's power to determine fully whether or at what rate Southern development occurs, but its policies can and do influence development in the South, for good or ill. One indication that development-oriented international reforms would have relatively limited impact upon the South (Cline, 1979, pp. 46–53) is that they could almost certainly be provided by the industrialized countries at very little cost. The issue is whether Northern countries help (or refrain from hindering) as much as they should, either in terms of their own interests or in some ethical sense.

### *The Developing Countries and the International Trading System*

During the 1970s the developing countries expended considerable energy in pursuit of reforms in the conduct of international primary commodity trade. They sought price-stabilizing international commodity agreements and a Common Fund in their support, together with a variety of related measures to assist with storage, processing and diversification. While reforms in primary commodity trade are still sought, the primary concerns of the developing countries for the past several years have been the growth in protectionism and the increasing disarray in the international trading system.

Tariffs on manufactured goods trade have gradually been bargained down over the post-World War II period in a series of GATT rounds. The developing countries have complained throughout, however, that the smallest cuts were on manufactures which are intensive in the use of unskilled labour and on processed raw materials, products of greatest relative importance to them. This imbalance in the structure of tariff reduction reflected the weak bargaining strength of the developing countries in the multilateral negotiation process. This bias continued in the Kennedy and Tokyo rounds despite their use of a formula for determining the depth of tariff reductions, because of extensive resort to exceptions to the formula-based cuts. In virtually all recent studies of the structure of national tariffs in the OECD countries,<sup>8</sup> unskilled-labour intensity is among the characteristics of the industries in which tariff protection is highest; it is also a key characteristic of the industries in which developing countries have the greatest comparative advantage.

As tariffs have gradually been reduced, non-tariff measures to restrain imports have steadily become more important in limiting the opportunities for developing countries to export manufactured products.



Resort to these new measures may have been accelerated by global recession, but the shift from tariff to non-tariff instruments was noticeable before this and is bound to survive eventual recovery. Import quotas, orderly marketing agreements, voluntary export restraints, and a host of other “new protectionist” instruments of trading policy have increasingly been deployed in discriminatory — or, as some would prefer to have it, “targetted” — fashion against sources of overseas competition. Discrimination against “low-cost” sources in the application of these non-tariff restraints on trade has been authorized under the GATT in the textiles and clothing sector through a series of agreements now termed the Multi-Fibre Arrangement.

Developing countries fear that they will increasingly be subjected to similar discriminatory treatment in other sectors in which they pose competitive threats to OECD industry, such as footwear, leather products, steel, electrical products, and automobiles.

The relative shift from tariff barriers to the “new protectionist” instruments of quotas, voluntary restraints, contingent barriers dependent upon lawyer-intensive adversarial procedures, and administrative measures are particularly damaging to the developing countries. Such non-tariff restraints are more difficult to overcome than tariffs and can more readily be directed in discriminatory fashion against the most competitive suppliers, usually the “low cost” developing countries. Voluntary export restraints increase the potential for exporting countries to earn “rent” from such restraints — the differential between the price at which exporters are willing to supply and the higher price at which the product can be sold, because restraints limit supply of the product in the protected market — and thereby may soften the protectionist blow for them, at least relative to their position when import quotas or tariffs are imposed. This is small comfort, however, when restraints are as restrictive as they have been in recent years. Moreover, new entrants to already controlled markets are being restrained at very low levels of trade, so that there are few incentives for investors to develop new sources of restricted products. As far as contingent and discretionary measures are concerned, small firms and developing countries are always likely to be at a disadvantage in gaining the ear of decision makers, presenting their case, and making credible threats of retaliation. New and small suppliers typically are hurt the most by the extra expense, uncertainty and delay implicit in these measures.

The costs of Northern protectionism are not confined to the newly industrializing countries (NICs). Scores of other developing countries either are contemplating entry to more export-oriented manufacturing or have already embarked upon it. New market entrants can expect to displace the NICs in the “early stage” industries as the latter move “up market” to more skill-intensive and capital-intensive industries. All the developing countries therefore have a great deal to gain from the reining

in of the new non-tariff measures and from greater adherence to the original GATT principles of non-discrimination, transparency and multilateralism, to which all still pay lip service. Since the developing countries are the prime losers from the current disordered international trading scene, they regard genuine adherence to GATT principles on the part of all members as a priority objective. This would, above all, involve the rewriting of the GATT's safeguard clause (Article XIX) to reduce evasion by sharpening the definition of the circumstances in which it can be employed, setting firm time limits upon its use, retaining the non-discrimination requirement, and strengthening surveillance and dispute settlement procedures. All quotas and voluntary export restraints would then be subject to one set of principles and procedures. The Multi-Fibre Arrangement would have to be phased into the more generalized arrangements. The GATT's existing codes, particularly those on export subsidies, anti-dumping duties and countervailing duties, also require considerable definitional and legalistic sharpening, and extension on an unconditional basis to all GATT members.<sup>9</sup>

The sectoral approach to trade issues now found in textiles and clothing seems likely to develop further during the 1980s and 1990s. Governments and transnational corporations will increasingly seek to reach accommodations with respect to investment and trading arrangements consistent with a reasonable degree of order and predictability. Whereas much of the current Northern debate over the feasibility of developing industrial policy relates to the "picking of winners" and the more effective realisation or creation of comparative advantage, the developing countries see OECD industrial policy as a probable smoke-screen for the protection of senescent industries that ought to be more rapidly phased out.

The developing countries have reason to fear the ways in which such international industrial policy and planning may emerge. The "free markets" to which OECD governments are rhetorically committed do not seem to be too active in their own arrangements in such industries as textiles and clothing, footwear, and steel, not to speak of agriculture. Information exchange and discussion within OECD sectoral committees are unlikely to give adequate consideration to the interests of non-OECD members, and developing countries have been understandably reluctant to participate in them on the infrequent occasions when they have been selectively invited. The Multi-Fibre Arrangement is illustrative of the possibility that even fully multilateralized consultations can generate discriminatory and costly international agreements. (The developing countries that have reluctantly signed this agreement have obviously concluded that their trade prospects in that sector would otherwise be even worse.) In one way or another the developing countries must be represented in the sectoral-level international consultative processes that increasingly govern patterns of international investment and trade.



An apparent offset to the discrimination by OECD countries against the manufactured exports of developing countries is the Generalized System of Preferences (GSP). This “system,” initiated within the UN Conference on Trade and Development and later sanctioned by the GATT, was intended to provide preferential tariff treatment for manufactures from developing countries, to encourage their industrialization. As eventually implemented, it proved to be a shadow of the original concept, because each industrialized country placed major restrictions upon eligibility. “Sensitive” products (like apparel) were ineligible; rules of origin were restrictive and complex; limits were placed upon the extent of usage; and preferential rates, not being “bound,” were subject to unilateral abrogation without compensation.<sup>10</sup> As most-favoured-nation tariff rates — those negotiated in the GATT and applied in non-discriminatory fashion — continued to fall, the value of these preferences, which was small to begin with, dropped even further. The value of the General System of Preferences to the developing countries today, while not zero and therefore not to be abandoned without a struggle, is a small fraction of the cost of the panoply of discriminatory trade policies now directed against them. The developing countries would undoubtedly be content to “graduate” from the positive preferential tariffs of the General System, an apparent primary concern of the United States at present, if they could also graduate from the special negative treatment they receive in the Multi-Fibre Arrangement or the similarly selective treatment that may lie ahead in a variety of other industries.

The trade system of the future is best pursued in terms of fully multilateral participation. This requires that participation in the GATT be expanded to include a large number of developing countries and some of the socialist ones. It requires resistance to the notion of pushing forward with a small number of “like-minded” OECD members (what some call a “GATT-plus” or “super-GATT”), leaving the rest out of the emerging system. The GATT-plus way, superficially attractive, leads inevitably to a tiered world of trading (and probably monetary) blocs and spheres of influence. Special preferential areas — whether within the North, within the South, or North-South in makeup — run the risk of similar outcomes. Increasingly, South-South trade has recently possessed a momentum of its own and may not require special arrangements in its support. Difficulty in gaining access to Northern markets is nevertheless bound to generate more Southern discrimination against Northern products in favour of Southern ones, in the spirit of “collective self reliance.”

The risk of an ever more protectionist “fortress OECD” with its own internal rules, discriminating against all outsiders, is a real one. The OECD already has its own rules for invisibles flows, restrictive business practices, and transnational corporate activity. The conditional character of the new GATT codes on export subsidies and government procurement, together with the Multi-Fibre Arrangement and the emer-

ging structure of voluntary export restraints — some of which are also deployed against Japan, which has been only partially accepted into club membership — exhibit similar characteristics on the trading scene. The OECD also provides for on-going consultations in a wide variety of other trade-related areas — including those, discussed above, at a sectoral level — rendering outsiders peripheral to deliberations that are of major consequence to them. The challenge is to devise arrangements that are both fully multilateral and workable.

## *The Developing Countries and the International Financial System*

### *Evolution of the International Monetary System*

The 1979 oil price shock and subsequent severe global recession imposed heavy strains upon the international financial system, which was in a state of unusual flux throughout the 1970s. The breakdown of the Bretton Woods exchange rate regime early in the decade, the first oil price shock, the enormous growth in the relative importance of commercial banks in international lending, and the continuing inability of the International Monetary Fund to influence world liquidity or exercise “firm surveillance” over its members’ macroeconomic policies, all generated rising unease even before the major shocks of the 1979–83 period.

The global financial system grew in a manner quite unlike that envisaged by the architects of the Bretton Woods system. The volume of liquidity turned out to be subject to the vagaries and herd-like instincts of commercial bank decision makers, and its distribution was heavily biased against the poorest countries. The IMF’s resources — quotas and SDR allocations — were held back in the light of the liquidity available to its major members from other sources, and failed to keep pace with the rising value of trade. For those without significant access to commercial bank credit — the poorest and least developed — this meant less and less adequate provision for meeting temporary balance-of-payments difficulties. Modest improvements in the forms of Trust Fund lending (from some of the proceeds of IMF gold sales), a broadened compensatory financing facility, a temporary oil facility to meet the needs of the first oil shock, and enlarged borrowing rights relative to quota size, still left the poorest without the liquidity necessary to meet the demands of a medium-sized shock. The heavy blows of the post-1979 period left these countries with no options but savage deflation and import cutbacks, the development effects of which will take years of recovery to overcome. Such credits as the IMF could offer during the 1979–83 period were on highly conditional terms. Whereas during the oil shock *cum* recession of the middle 1970s its credit for developing countries was primarily (about two-thirds) on low-conditionality terms, that of recent years has been overwhelmingly (75 percent in calendar 1983) tied to tough performance



criteria (IMF, 1983b, p. 86; IMF, 1984, p. 41). (The longer-term adjustment needs of many developing countries were at the same time recognised via the IMF's "extended" facility and, at least in principle, in greater supply-side orientation in its advice.) Following the virtual cessation of net new commercial bank lending of an "unforced" kind from late 1982 onwards, developing countries which had been considered more creditworthy were also increasingly driven to the IMF. The adequacy of IMF resources and the conditions on which the IMF lends have therefore become major areas of North-South discussion and debate. Conditionality has become particularly contentious as aid donors and other sources of credit have increasingly relied upon the existence of an agreement with the IMF as a condition of their own further resource flows (Williamson, 1983; Dell, 1981; Commonwealth Secretariat, 1983; Killick, 1984a; 1984b).

The total inadequacy of existing mechanisms for carrying low-income countries through temporary balance-of-payments difficulties caused by external shocks has been a particularly pressing concern. Neither the quota-related (as opposed to need-related) borrowing rights under the IMF's compensatory financing facility nor the European Community's STABEX program could offer more than a fraction of the resources required by these countries in the 1979–83 episode.

The World Bank, originally intended primarily to meet needs for long-term development finance, mainly for projects, has inevitably been drawn into the shorter-term problems of adjustment to an extended period (possibly permanent) of worsened terms of trade and unusually severe and extended recession. Development projects cannot succeed in the midst of massive macroeconomic dislocation and import "strangulation." The Bank has tried to assist in meeting balance-of-payments needs and structural adjustment requirements through its new "structural adjustment lending," accelerated disbursements in a "special action program" for middle-income countries, and expanded non-project lending to poorer countries. Like the IMF, the Bank faces constraints upon its resources. In particular, the International Development Association (IDA), the Bank's soft-loan affiliate which lends only to the lowest-income countries, has suffered a major cutback in the size of its operations under pressure from the United States. The amount negotiated for the Seventh IDA replenishment (1984–87 period) is US\$9 billion, well below the \$12 billion agreed for 1980–83, or the \$14 billion, including supplementary funding, actually contributed in 1980–84. This replenishment is slightly over half the amount estimated by the Bank staff as necessary for the Bank to continue its recent level of lending activity with the addition of China to its clientele. Efforts are being made to make up some of the shortfall with a supplementary fund to which all donors other than the United States will contribute, but the outcome of these negotiations remains uncertain.

The difficulties of the international financial system, discussed further below, have generated calls for a World Monetary Conference, a “New Bretton Woods,” from the Non-Aligned Movement and others, including the former Prime Minister of New Zealand (Muldoon, 1983; see also Commonwealth Secretariat, 1983). It is safe to say that the reform of the international financial system, particularly the IMF and the World Bank, is at present the highest-priority item on the international agendas of the developing countries. Most of them see it in terms of a broader review of the entire international economic institutional machinery, including trade institutions (notably the GATT) as well as the Bretton Woods machinery, narrowly defined. Any discussion of Canadian financial relations with the developing countries must be seen against this broader backdrop.

### *Recent Financial Crises in the Developing Countries*

The severity of the global recession and the unusual conjuncture of sharply deteriorated terms of trade and very high interest rates on external debt, now largely on floating rate terms, have created severe balance-of-payments difficulties in the developing countries. These have been intensified by severe cutbacks in commercial bank lending to these countries (not least by Canadian banks), only partially compensated by expanded IMF and other intergovernmental financial flows. Provided that these trading and borrowing circumstances are purely temporary, the problems can be seen as liquidity problems — inability to convert a fundamentally sound financial position quickly into ready cash. Shortages of liquidity can and should be met by the provision of temporary credit and/or the rolling-over and rescheduling of current debt repayment obligations.

To this end there has been an unprecedented burst of official and commercial bank debt rescheduling and restructuring operations in the past few years. Official debt negotiations are normally conducted via the so-called “Paris Club,” but sometimes through other special creditors’ arrangement or through the OECD. While there had been only ten official debt renegotiations between 1975 and mid-1979 (three concerning Zaïre and two concerning Turkey), in the next four years there were fully 27. Commercial banks have also been obliged to restructure their loans to developing countries to a highly unusual extent in recent years. In the six years up until 1982 there were only nine commercial reschedulings, typically of small amounts. In the next year, 15 countries renegotiated their debt with commercial banks, and the amounts being restructured were 20 times larger than those in any previous year (Mendelsohn, 1983, p. 3). Table 6-2 lists the 27 countries engaged in commercial bank restructurings in 1983.

To the extent that current balance-of-payments difficulties are the product of permanent worsening in the international payments positions



**TABLE 6-2 Countries Engaged in Bank Debt Restructurings**  
(Ranked by debt to banks at end of December 1982)<sup>a</sup>

(US\$ million)			
Mexico	62,888	Sudan	1,119
Brazil	60,453	Bolivia	940
Venezuela	27,474	Zaire	873
Argentina	25,681	Dominican Republic	866
Chile	11,610	Nicaragua	814
Yugoslavia	9,821	Zambia	590
Nigeria	8,527	Jamaica	521
Peru	5,353	Honduras	469
Ecuador	4,488	Senegal	410
Romania	4,243	Madagascar	299
Turkey	3,971	Togo	253
Morocco	3,882	Malawi	202
Uruguay	1,531	Guyana	129
Costa Rica	1,261		

*Source:* International Monetary Fund, "Recent Multilateral Debt Restructurings with Official and Bank Creditors," *Occasional Paper*, 25, Washington, 1983.

a. Includes IMF member countries that are currently in the process of formal multilateral debt restructuring (i.e., rescheduling or refinancing) with commercial banks or have completed such a process since 1978. Liberia, which completed a renegotiation in 1982, is not included because of its status as an offshore financial centre.

of developing countries, the only "remedy" is adjustment to the new circumstances through restraint and restructuring. Countries that incurred heavy foreign debt in the expectation of a better international environment than the one now anticipated may be faced with more than short-term liquidity problems. They may have to be seen instead as essentially "insolvent," i.e., unable or unlikely to repay their external debt. If so, the provision of further credit will not ease their difficulties, because the rate of return on capital falls short of the rate of interest. The line between "insolvency" and "illiquidity" in each country is a fine one and is ultimately a matter of forecasting and judgment. A number of analyses conclude that in order for the major developing country borrowers to remain "solvent," i.e. to be able to meet their international debt servicing obligations in the next few years, OECD growth must attain a real annual rate of at least 3 percent (Cline, 1983a). This prospect is by no means assured.

The financial crises of the developing countries have brought about a new era in IMF activity. Previously, the IMF tried to stay at arm's length from commercial creditors, but it has now emerged as an important coordinator and organizer of joint official/private financial "rescue" operations. Its seal of approval for domestic stabilization and adjustment programs has become more important than ever — the very centrepiece of the international debt restructuring and adjustment process. While its own resources remain relatively slim, its influence over the formulation of appropriate adjustment programs and the willingness of

major creditors to continue their lending have been of enormous importance. The stability of the international financial system depends in substantial part on the continuing credibility of the IMF, and that requires that the Fund have sufficient resources to retain its credibility. Failing that, responsibility will be thrust increasingly upon the monetary authorities of the United States, the ultimate lender of last resort if the primarily dollar-denominated assets of the international banking system turn sour.

The debt crisis of the developing countries has dramatically underlined the degree to which Northern domestic macroeconomic policies are linked with their financial and trade policies toward the Third World. If the recession in the industrialized countries had been less severe and the monetary-fiscal policy mix had not generated such high interest rates, most Third World debtors would have experienced few difficulties in their debt servicing. If continued protectionist measures make it more difficult for debtor countries to earn foreign exchange, there will be obvious international financial implications. There are as yet no adequate means of addressing these interrelated policy questions in a holistic fashion at the level of either national governments or international organizations. It makes little sense to conduct discussions and negotiations on the servicing of Mexican or Brazilian debt in one set of institutions (the Department of Finance, the Bank of Canada or the IMF) while the trading circumstances that the country needs to generate the necessary foreign exchange to service the debt are discussed in another (the Anti-Dumping Tribunal, the Textile and Clothing Board, External Affairs, or the GATT). The link may also be put the other way around: the provision of more liquidity and adjustment finance for developing countries will ease the pressure upon them to sell more manufactured exports in already-depressed Northern markets.

Some major developing country borrowers may ultimately be unable or unwilling, either singly or collectively, to meet their future debt servicing obligations in full. Exposed commercial banks have begun to set aside significant loss reserves against such an eventuality. In the United States, bank regulators already require banks to write down the value of loans to selected developing country borrowers. Proposals abound for a major debt refunding exercise — to lengthen maturities, ease interest rates, soften austerity measures, and thereby assist hard-pressed borrowing countries to get back on their feet (Cline, 1983a). These refundings might be undertaken by the World Bank, the IMF, some new international financial agency, or the governments of the industrialized countries acting individually on behalf of their own banks. To the extent that the refunding would involve subsidies, the difficult question is how to distribute the burden of their financing. A suitable financing bargain would have to be struck among the following “players” — the borrowing developing countries, the exposed commercial



banks (and their shareholders, depositors and other customers), the governments of the countries in which the banks are based (and their taxpayers), and, quite possibly, the other, non-debtor, developing countries from which resource flows could be deflected in a major refunding exercise. No such agreement looks attainable as yet.

Similar issues regarding the distribution of losses would arise in the event of default by developing countries. The prospect of default also raises the issue of whether adequate international lender-of-last-resort facilities are in place to protect the stability of the international financial system against resulting severe liquidity shocks. There is understandable reluctance to discuss in public the details of contingency arrangements among the major central banks of the industrialized countries, but the price of this reluctance is limited confidence in official preparedness for what has become a fairly realistic prospect (Lipton and Griffith-Jones, 1983; Guttentag and Herring, 1983). Even with adequate contingency planning, defaults on developing country debt would impart a heavy blow to the global financial system and to growth in the industrialized world. The ensuing shock to confidence and the inevitable associated tightening of credit would not only set back overseas lending for a substantial further period, but also have a severe impact on Northern investment.

The ad hoc restructuring and financial bailout arrangements cobbled together by the principal creditors have worked reasonably well so far, but a more systematic means must be devised for assembling and disseminating relevant financial information, particularly on short-term and private sector debts, and for treating debtors predictably and equitably. The developing countries, with UNCTAD support, have long sought more systematized and predictable debt restructuring arrangements. The creditors have preferred to treat each case as *sui generis*. The price they may now pay is the development of debtors' clubs to exchange information and pursue their joint needs more effectively. It is not too late to seek to establish general rules or codes governing debt negotiations and restructuring arrangements. More important, the recent restructurings have postponed only slightly the eventual need for debt amortization. Unless global recovery is more rapid than most now expect, major balance-of-payments difficulties and renewed debt crises will soon reappear in many developing countries; certainly they will be experienced during the next overall recession. Another oil price shock remains a real danger to the process of orderly macroeconomic adjustment and debt servicing. Fundamental policies for refunding Third World debt into longer-term and more flexible (equity-like) form deserve more attention than they have so far received from Northern governments.

In retrospect it is possible to see that the entire system of development financing became seriously unbalanced in the 1970s. Even if their

expanded financing role were still acceptable, commercial banks are not soon prepared to resume their previous levels of Third World lending. New sources of both medium-term and long-term finance are therefore needed, and they must be less rigid in their terms and more stable in their flow, with maturities appropriate to the purposes of the loans. A relatively greater role for equity and equity-like investments seems inevitable and desirable. To this end, it would be helpful if an international code of conduct for transnational corporations could at last be agreed to on terms that are acceptable to home and host countries and to responsible business. New efforts should also be directed to opening bond markets to developing countries and developing more flexible financial instruments to attract venture capital to them. If these goals are not achieved in the sphere of private finance, the only alternative will be to resort again to official institutions. The World Bank may have an especially critical role to play in both financial innovation and expanded direct financing of Third World development, and the IMF is likely to take a greater part in providing liquidity, with less liquidity provided by the commercial banks than in the 1970s.

## **Southern Objectives and Canadian Interests**

The developing countries seek policy changes and institutional reform in a wide variety of trade, monetary and financial matters. Some of their objectives are highly specific to particular issues or countries, but North-South discussion has typically been focussed on the more general proposals. Table 6-3 lists what are probably the main general objectives of the developing country group at present.

Canada has generally gone along with joint Northern responses to these Southern proposals. However, Canada and the developing countries have some common interests with respect to particular issues of North-South dispute (North-South Institute, 1977, 1979, 1980a, 1980b). As a primary exporting country, for example, Canada might be expected to share an interest — at least in broad terms — in efforts to improve the international “regime” for primary products trade: price stabilization and the reduction of escalated protection for primary processing activities. As an importer of technology and other services, Canada and some developing countries take a similar view of the problems in international technology markets, trade in services, and the appropriate content of relevant codes. The substantial stock of direct foreign investment in Canada also permits it a degree of identification with developing countries’ approaches to codes on transnational corporate activity and restrictive business practices at the international level.



**TABLE 6-3 Principal Objectives of the Developing Countries  
in North-South Negotiations**

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**Trade**

- Standstill on further protection and eventual phasing down of existing protection against Third World exports.
- Cessation of discrimination against “low-income” suppliers and renegotiation of GATT safeguard clause (article XIX), to prohibit future discrimination.
- Reduction of protection on agricultural and primary processing activity in which developing countries are competitive.
- Phase-out of the Multi-Fibres Arrangement.
- International commodity (and energy) price stabilization at reasonable levels and establishment of an effective Common Fund.
- Adoption by the OECD of serious adjustment assistance programs in unskilled labour-intensive industries.
- More effective implementation of GATT codes on non-tariff measures and their application on an unconditional most favoured nation (MFN) basis.
- Renegotiation of the Generalized System of Preferences and adoption of internationally agreed procedures for graduating beneficiaries from their preferential status.
- Strengthening of the international machinery for the supervision of international trade.
- Strengthening of the international control of restrictive business practices.
- Agreement on a comprehensive and binding code on the international transfer of technology.
- An effective world food security system.
- Support for expanded South-South trade.

**Monetary**

- Further quota increases in the IMF and regularised provision for future increases.
- Issue of SDRs and provision for regular future issues in accordance with global needs.
- Expansion and reform of the IMF’s compensatory financing facility.
- Greater sensitivity to specific national circumstances and to the origins of difficulties in the application of conditionality.
- Contingency clauses attached to performance targets associated with IMF conditional lending.
- Motion toward a system in which the SDR is the principal reserve asset.
- A World Monetary Conference to discuss broader issues of systemic reform.

**Financial**

- Expansion of the resources of the World Bank and IDA.
  - Improved access of developing countries to international money and capital markets.
  - Agreement on an international code of conduct for transnational corporations.
  - Achievement on the part of all Northern countries of a target of 0.7 percent of GNP devoted to official development assistance and 0.15 percent for assistance to the least developed countries.
  - Reduction of harmful procurement tying of official development assistance.
  - Greater automatic resource mobilisation for development assistance through global taxes.
  - Restructuring of international debt at reasonable terms, with regularized procedures for future debt negotiations.
-

Canada's potential common interests with the developing countries go much deeper, however, than these particular instances of shared approaches within narrowly defined issue areas. Much more fundamental is the shared interest of smaller and more trade-dependent countries in the healthy functioning of the entire international economy. In current circumstances with the international economy under great stress, many fear for the future of the international economic institutions, originally created out of the chaos of the Great Depression and World War II. Since Great Power leadership is lacking at present, someone must begin to pick up the pieces.

Very few of the developing countries were present in 1944 at the Bretton Woods conference which led to establishment of the IMF and World Bank, or at the Havana conference of 1947 which led to establishment of the GATT. Most of the developing countries were not yet independent. Those that were independent and present at the meetings had very limited influence. They have therefore argued that the IMF and the GATT did not adequately take their interests into account. It is generally recognized that the Allied Powers did have other concerns uppermost at the time. Both the Bretton Woods institutions and the GATT have evolved considerably in response to the many changes in the global economy and polity over the past 35 years. But these central pillars of the post-war international economic system are now widely seen as undesirably weak and in need of significant improvement (e.g., Commonwealth Secretariat, 1983). The developing countries probably suffer most from an inadequately functioning world economy and are therefore strong advocates of any reforms contributing to increased global economic stability, efficiency, growth and equity.

Recent international economic disarray has led the developing countries to advocate a more effectively functioning *old* international economic order, whatever their preferences for a new one. Without dropping any of their original aspirations, the developing countries have recently adopted a more pragmatic and moderate tone in their approach to international economic affairs. They now appear readier to negotiate on a case-by-case basis on particular issues of major concern to them, such as international monetary reform, and to participate in any forums likely to be effective rather than insisting upon holistic approaches within the United Nations.

In the sphere of macroeconomic management and international finance, the developing countries are now the principal defenders of the original principles and more recently agreed adaptations of the Bretton Woods institutions. They are the ones who call with greatest vigour for strengthening the IMF through adequate quota expansion; instituting measures to reduce the volatility and misalignment of the major currencies; centering the international monetary system upon the SDR; improving international macroeconomic cooperation in pursuit of the



IMF's primary objectives of maintaining employment and growth both nationally and internationally; and resuming the process of reform initiated by the IMF's Committee of Twenty in the early 1970s. In the trade sphere, the developing countries, while not without sins of their own (some of which have been formally authorized by the GATT), are now the principal exponents of non-discrimination, transparency and multilateralism in an increasingly fragmented, bilateralized and discriminatory trading order. They also remain vigorous champions of many of the sections of the defunct International Trade Organization that were dropped in favour of the much narrower GATT after the U.S. Congress failed to ratify the ITO's charter in 1948.

Earlier rancour in North-South relationships has obscured the new realities: the developing countries are, in effect, now calling for a return to the original principles of the IMF-GATT system and for greater adherence to multilateral norms that have already been accepted. They seek an appropriate rebuilding of tottering international economic institutions because they suffer the most from the weakness of these institutions.

But the developing countries are not the only disproportionate losers from a rickety global economy. Smaller and middle-sized industrial economies also have much to lose from weak or disintegrating international economic arrangements. They are typically highly dependent upon the effective functioning of international markets for goods, services and capital, and consequently suffer greatly from externally created economic shocks. At times of overall economic instability, they face much greater uncertainties than do the Great Powers — which can exercise some influence over events and insulate themselves somewhat against the effect of actions elsewhere in the world. Declining respect for international rules and multilaterally agreed dispute settlement procedures is disproportionately damaging to smaller, poorer and more open economies. Relative to larger powers, these countries have greater interest in multilateral approaches to conflict resolution and dispute settlement; openness and transparency in the conduct of international economic affairs; non-discrimination as a fundamental principle of international economic relations; and risk avoidance in terms of global macroeconomic management. Their self-interest is therefore, on the face of it, more nearly coincident with the *general* global interest than is that of the Great Powers upon which the key decisions continue to depend. Illustrative of this *Realpolitik* is the fact that the most vigorous recent exponent of “a new Bretton Woods” was the otherwise very conservative former Prime Minister of New Zealand.

In the present world circumstances, particularly great opportunities may be realized from a more conscious banding together of middle and smaller powers, including the developing countries. The international economy is in a state of considerable disarray and even disrepair. It

urgently requires the initiation of a process of negotiation for reform. The current leadership in the Western world (notably in the United States) is unfortunately not apparently in the mood for such an initiative. Neither is it entirely clear in which direction the Reagan administration would now want to lead such a negotiation process. Recent and current U.S. positions on replenishment of the International Development Association, the appropriate size and character of World Bank and IMF activities, the Law of the Sea, the management of exchange rates, the consideration of international effects in the development of domestic macroeconomic policies, East-West trade, and a host of other areas are profoundly antithetical to the view of the majority of its own (increasingly distressed and embarrassed) allies.<sup>11</sup> It may therefore be time, as the eminent Canadian diplomat John Holmes has recently put it (1983), for a "resurrection of middle power diplomacy." (See also North-South Institute, 1983b, p. 11).

The stalemate in North-South negotiations, growing evidence of a "Fortress North" mentality within the industrialized countries, and the prospect of a slowdown in the Northern engine of growth, have generated increased Southern interest in South-South cooperation. Regionally and functionally organized blocs of countries are inevitable and frequently desirable within the international economic system. It would be most unfortunate, however, if the world were to become divided along North-South lines, which is a real danger at present, or if Northern relations with the South were to be channelled to an increasing extent through competing "spheres of influence." The challenge of the next few decades will be to integrate the developing countries smoothly and equitably into an international economic system that is fully multilateral on mutually agreeable terms.

Traditional blocs within the international system, whether based upon regional, functional or ideological considerations, may serve some useful purposes. As a basis for overall international economic arrangements, however, they are likely to land middle powers and smaller countries in the greater powers' spheres of influence. The overall individual interests of middle and smaller countries are almost certainly best preserved in fully multilateral arrangements in which their collective interests and strengths have to be taken into account. It is in this respect that Canadian interests most fundamentally coincide with those of the developing countries. Canada could attempt to play a more active middle-power role in the reform of the international economic institutional machinery than it has so far chosen to do.



## Canada's Economic Relations with the Developing Countries

### *Overall Perspectives*

Canada's economic relations with developing countries as a group are summarized in Table 6-4. Merchandise trade flows are far and away the most important component of flows between Canada and developing countries. Transactions on services account, for which detailed data are not available, must also be substantial. Existing stocks of Canadian direct foreign investment and bank lending in the developing countries give rise, by themselves, to further Canadian receipts, which are probably more than half as large as those on merchandise account.<sup>12</sup> Even excluding OPEC, Canadian merchandise imports from developing countries are twice as large as total Canadian government-to-government outward flows, concessional or otherwise. Official development assistance (bilateral plus multilateral) has totalled less than one-third of the value of Canada's non-OPEC imports.

Aid flows have traditionally dominated the capital account of Canada's economic relations with developing countries. In 1980 and 1981, however, before their subsequent collapse, private Canadian capital flows made up over half of total net resources flows from Canada to these countries.

Also of interest are recent changes in the composition of Canadian immigration. Since the mid-1970s, when more universal immigration policies were formalized, the developing countries have been the source of over half of Canada's new immigrants, a striking increase from only 4.6 percent in 1956 and 11 percent in 1961.<sup>13</sup> These immigrants have contributed importantly to Canada's economic well-being. However, the professional and skilled component of this out-migration (the so-called "brain drain") has almost certainly involved losses for the developing countries (Economic Council of Canada, 1978, pp. 113-127).

### *Canada's Trade with the Developing Countries*

#### *The Changing Role of Developing Country Trade*

A relatively smaller share of Canada's total international trade has been transacted with the developing countries than the share in other OECD countries, as shown in Table 6-5. This proportion grew rapidly during the 1970s. Table 6-6 shows that 11.9 percent of Canada's total imports in 1982 were from developing countries (up from 8.3 percent in 1970) and 9.8 percent of total exports were sold to them (up from 7.4 percent in 1970). In 1970 developing countries accounted for 30.9 percent of Canada's non-U.S. exports and were the source of 40.4 percent of Canada's non-U.S. imports. Looking only at manufactured exports, developing coun-

tries made up 45.9 percent of Canada's total non-U.S. exports in 1982, more than the EEC and much more than Japan. These Canadian exports were directed primarily at Latin America and East Asia, with OPEC countries also accounting for a major share of the developing country total.

**TABLE 6-4 Main Elements in Canada's Balance of Payments with Developing Countries**

	1980	1981	1982
		(US\$ millions)	
Current Account			
Imports from developing countries	7,817		6,503
OPEC	4,492		2,538
Other	3,325		3,965
NICs	2,149		2,977
Near-NICs	373	1,176	988 { 380
Other	803		608
Export to developing countries	6,803		6,705
OPEC	1,872		2,147
Other	4,931		4,558
Capital Account			
Bilateral official development assistance (ODA)	657	746	827
Other bilateral official flows	678	280	569
Grants by private voluntary agencies	102		123
Private flows			
Direct investment	400	700	-210
Bilateral portfolio investment	1,282	1,800	—
Private export credits	-39		-148
Multilateral flows			
ODA — contributions to multilateral institutions	418		370
Other official flows — to World Bank	-17		—
Private multilateral portfolio investment	1		-2

*Source:* Department of External Affairs, International Trade Data Bank; Organization for Economic Co-operation and Development, *Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, 1983, Review* (Paris, 1983).

*Note:* For the purposes of categorizing developing countries in this and subsequent tables showing Canadian trade patterns: "newly industrializing countries (NICs)" are made up of Brazil, Mexico, Hong Kong, South Korea, Taiwan and Singapore; "near-NICs" are made up of Argentina, Chile, India, Pakistan, Egypt, Colombia, Malaysia, Philippines and Thailand; and "OPEC" countries are comprised of Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, United Arab Emirates, Venezuela, Muscat and Oman. These categories are less than totally satisfactory but are employed by the trade data bank in the Department of External Affairs.



**TABLE 6-5 Developing Countries' Shares of Exports and Imports of Industrialized Countries, 1979**

	Imports (c.i.f.)	Exports (f.o.b.)
	(percent)	
Canada <sup>b</sup>	11.1	8.6
United States <sup>b</sup>	45.1	34.6
Japan	56.3	45.1
United Kingdom	17.3	21.2
France	24.4	22.5
Germany	18.8	14.3
Netherlands	21.2	10.2
Denmark	10.6	11.1
Norway	9.2	10.5
Sweden	13.1	12.9
Australia	22.3	27.7
OECD <sup>c</sup>	28.2	23.6
U.S.S.R. <sup>a</sup>	14.5	13.5

*Source:* Robert Cassen, Richard Jolly, John C. Sewell, and Robert Wood, eds., *Rich Country Interests and Third World Development* (London: Croom Helm, 1982), pp. 352-55.

*Note:* c.i.f. = cost, insurance and freight  
f.o.b. = free on board

a. 1978

b. Imports f.o.b.

c. The OECD definition of developing countries includes Yugoslavia. Elsewhere in this table Yugoslavia is not included.

**TABLE 6-6 Developing Countries' Shares of Canadian Trade**

	Percentage of Total		Percentage of Total Excluding U.S.	
	1970	1982	1970	1982
Imports				
Primary products	21.0	17.1	45.7	45.1
Fuels	68.8	57.0	97.8	90.3
Manufactures	1.9	5.2	8.4	21.9
Other	3.9	5.3	15.5	24.5
Total	8.3	11.9	28.6	40.4
Exports				
Primary products	8.3	12.9	14.7	20.5
Fuels	0.3	2.1	7.6	18.7
Manufactures	7.6	10.4	29.7	45.9
Other	5.9	4.3	28.6	38.1
Total	7.4	9.8	21.3	30.9

*Source:* Department of External Affairs, International Trade Data Bank.

Table 6-7 shows the product and country composition of Canadian trade. Fully 59 percent of exports to developing countries in 1982 were manufactured products, more than the average for Canadian exports to the rest of the world. The share of manufactures was particularly high in Canadian exports to the “near NICs” and OPEC countries in Latin America and the Middle East. Nearly half of Canadian imports from developing countries have been fuels. By 1982 about one-third of imports were manufactures (up from only 19 percent in 1970) and this trade was mainly from the NICs and near-NICs. Non-fuel primary products now account for only 17 percent of Canadian imports from developing countries, although they still dominate the export trade of the majority of developing countries.

It is noteworthy that Canada runs a trade surplus with the developing countries as a group, both in manufactured goods trade and in the aggregate. These surpluses increased over the 1970s, when deficits were rising with respect to the rest of the world. However, Canada now runs trade deficits with the newly industrializing countries of East Asia. In 1982, overall trade deficits were also run against Latin America and the OPEC countries (see Table 6-8). One element of Canada’s export trade with developing countries that attracts considerable attention and is likely to grow is food. Even with the most vigorous efforts to develop local food production, cereal imports of developing countries, which have tripled since 1961, are likely to continue to expand.

Overall, the Canadian economy is a relatively import-dependent (and export-dependent) one. Imports make up a high proportion of Canadian consumption of manufactures, by international standards. In 1980, 31.6 percent of manufactures consumption was imported, as against an industrialized country average of only 17.9 percent (see Table 6-9). Canadian manufactured imports do not, however, originate in the developing countries to the same degree as in other industrialized countries. Developing countries provide a smaller market share of Canadian consumption of manufactured goods than they have achieved in most other industrialized countries. In 1980, these imports amounted to only 2 percent of total Canadian manufactures consumption (up from 1.2 percent in 1970), as against 2.8 percent in the United States and 3.3 percent in the EEC, as indicated in Table 6-9. Thus, the developing countries remain *very* small players in the total Canadian industrial market.

Yet manufactured goods from developing countries have received disproportionate and highly discriminatory attention by Canadian and other OECD trade policy makers. The most successful industries of developing countries in terms of the penetration of OECD markets have been food, beverages and tobacco; clothing, textiles and leather; wood products; chemical products; metal products; and miscellaneous manufacturing. In each of these markets, the developing countries’ share of Canadian sales in 1980 was below their share of other industrial



TABLE 6-7 Product and Country Composition of Canadian Trade

	1970				1982			
	Primary Products	Fuels	Manufac- tures	Other	Primary Products	Fuels	Manufac- tures	Other
Imports								
Total Developing Countries	33	47	19	1	17	48	33	1
By Region								
Latin America	35	61	3	—	25	63	11	1
Africa	60	32	3	—	20	72	4	3
East Asia	20	—	75	1	10	—	88	1
South Asia	41	—	57	1	21	—	73	2
Middle East	3	96	1	—	1	98	1	—
By Category <sup>a</sup>								
NICs	42	—	56	1	14	21	64	1
Near NICs	36	12	45	1	48	4	40	3
OPEC	4	95	—	—	3	96	—	1
Other	71	24	3	1	74	8	11	6
World	13	6	80	1	12	10	75	3
World less U.S.	21	14	64	1	16	21	61	2

TABLE 6-7 (cont'd)

	1970				1982			
	Primary Products	Fuels	Manufac- tures	Other	Primary Products	Fuels	Manufac- tures	Other
Exports								
Total Developing Countries	37	—	62	—	35	3	59	1
By Region								
Latin America	29	—	70	1	37	1	60	2
Africa	70	—	29	1	46	—	49	1
East Asia	60	—	40	—	48	6	45	—
South Asia	47	—	53	—	43	3	51	—
Middle East	42	—	57	—	27	—	72	—
By Category <sup>a</sup>								
NICs	30	—	70	—	38	9	52	1
Near NICs	41	—	59	—	26	2	71	—
OPEC	24	—	76	—	30	—	68	—
Other	44	1	54	1	45	1	49	4
World	33	6	60	1	27	15	56	2
World less U.S.	54	1	44	—	54	5	40	1

Source: Department of External Affairs, International Trade Data Bank.

a. See note on Table 6-4.



countries' markets (see Table 6-10). In each of these categories except clothing, the developing countries' share of Canadian markets was also far smaller than the share imported into Canada from other sources. The fact that the developing countries have not begun to make a significant mark in the Canadian market intensifies their bitterness at being blamed for the difficulties of some domestic industries and at the same time being victimized by Canadian trade policies which systematically favour industrialized countries.

Developing countries have, however, had a significant impact upon some more narrowly defined markets. Table 6-11 shows those markets in which they had attained significant levels of market penetration by 1980 and those in which their market shares grew the fastest between 1970 and 1980.

### *Canadian Trade Policy and the Developing Countries*

Developing countries are unlikely to recognise Canada as the "Boy Scout" in international trade, although some domestic commentators and lobbyists describe it in such terms. In fact, the Canadian record with respect to discriminatory protectionism directed at the developing countries is similar to that of the rest of the OECD, despite the fact that developing countries have had only limited success in penetrating the Canadian market.

Looking first at tariffs, in the mid-1970s non-fuel imports from developing countries faced a weighted average tariff of 11.4 percent, as against an average of only 6.7 percent for imports from developed countries. The average tariff on manufactures from developing countries was over twice as high as that encountered by developed countries — 15.5 percent as against 7.2 percent (Havrylyshyn, 1983, p. 229). Tokyo Round tariff reductions negotiated in the 1970s treated "sensitive" Canadian industries with special care, with the result that the existing bias favouring protection for unskilled labour-intensive products was increased.

The Canadian general preferential tariff (GPT), among the last to be introduced among the industrialized countries in 1974, provides for a duty of two-thirds of the most-favoured-nation rate or the Commonwealth preferential rate, whichever is lower, for eligible products, together with specific preferences for selected agricultural products. Most textile products, footwear and some electronic products are ineligible for the GPT. A recent Tariff Board study noted that imports under the GPT amounted to 4.2 percent of Canadian imports from the countries of origin and 0.2 percent of total Canadian imports, in both cases excluding petroleum and natural gas from the total (1981, p. 8). The initial 10-year term for the GPT expired on July 1, 1984, and a further 10-year term was then agreed to.

**TABLE 6-8 Canadian Trade Balance with Developing Countries  
(Exports minus Imports)**

	Total		Manufactures	
	1970	1982	1970	1982
		(Cdn\$ millions)		
Total Developing Countries	91	202	535	1,817
By Region				
Latin America	17	- 819	448	1,165
Africa	6	806	28	562
East Asia	62	401	- 51	- 689
South Asia	134	321	68	142
Middle East	- 20	258	36	709
Other	10	75	9	54
By Category <sup>a</sup>				
NICs	29	- 1,007	55	- 884
Near NICs	216	649	143	581
OPEC	- 285	- 391	133	1,445
Other	129	853	202	643
World	2,836	13,569	- 931	- 3,111
World less U.S.	1,750	5,600	20	- 1,151

*Source:* Department of External Affairs, International Trade Data Bank.

a. See note on Table 6-4.

Non-tariff barriers became more important than tariffs in the 1960s and 1970s as a means of protecting some Canadian industries with which developing countries were most competitive. Voluntary export restraints on textiles from Japan and a number of developing countries were negotiated in the 1960s. In the early 1970s imports of clothing began to be similarly restrained; in 1976 these were replaced by global (non-discriminatory) import quotas, imposed under the safeguard clause of the GATT. Import quotas were imposed on leather and synthetic footwear late the following year. In 1979 the global quotas on clothing were replaced by a battery of bilateral agreements on voluntary export restraint with individual developing countries.

All of these measures were originally depicted as temporary departures from agreed GATT norms, but they are now regarded as firm parts of the Canadian industrial infrastructure and are likely to be extremely difficult to wind down. Indeed to date, far from being phased down, they have been progressively extended to cover more products and more countries. The Multi-Fibre Arrangement with its origins in a short-term agreement in 1962 relating only to cotton textiles, has repeatedly been renewed and its provisions have grown progressively more restrictive of "low-cost" textile and clothing products. The most recent renegotiation extends its provisions until 1986. Canada is thus committed to its system of restraints on clothing and textiles at least until 1986, with specifics



**TABLE 6-9 Market Penetration in Manufactured Goods Markets, Advanced Industrial Countries**

	1970			1980		
	All Imports	Developing Country Imports		All Imports	Developing Country Imports	
		a	b		a	b
		(percent)				
Australia	22.4	2.1		26.0	5.5	
Canada	26.9	1.3	1.2	31.6	2.1	2.0
European Community <sup>c</sup>	20.6	2.7	2.2	32.6	4.6	3.3
Belgium	59.1	5.9		84.6	6.7	
France	16.2	1.9		23.2	3.8	
West Germany	19.4	2.3		31.2	4.8	
Italy	16.3	2.2		31.7	5.2	
Netherlands	52.3	3.9		62.2	7.5	
United Kingdom	16.3	3.3		28.2	3.5	
Japan	4.7	1.3		6.3	2.5	
Sweden	31.3	2.8		38.0	3.8	
United States	5.6	1.3	1.2	8.7	2.9	2.8
Total	11.6	1.8	1.5	17.9	3.4	2.9

*Source:* North-South Institute.

*Note:* Imports as a percentage of apparent consumption.

a. Including Southern Europe.

b. Excluding Southern Europe.

c. Excluding Greece, which joined the European Community in 1981.

likely to be renegotiated on a yearly basis. In the 1970s, the government in effect abandoned its previous intention to require the industry to achieve international competitiveness, stating instead a new position that only competitiveness with other industrialized countries was to be sought. Gradually, discriminatory treatment of developing countries' exports has thus been legitimized not only in Canada but also in the rest of the OECD.

In 1983, Canada was imposing restraints on 15 textile products and 16 types of apparel coming from 18 countries, of which 13 were developing countries<sup>14</sup> and the rest centrally planned European ones. There were a total of 179 separate restraint agreements, plus licensing requirements involving consultations or export authorizations in another 27 clothing and textile products. It is noteworthy that among the restrained countries are some that are very poor and have barely begun to make an impact upon Canadian markets. Biggs (1980, p. 85) notes that "Sri Lanka's 'disruptive' imports of tailored collar shirts accounted for only 0.02 percent of total Canadian imports of this good in 1979, when

TABLE 6-10 Import Penetration in Particular Markets in Canada and the Industrially Advanced Economies, 1980

	Canada			Industrially Advanced Economies		
	Imports from Developing Countries	Other Imports	Total Imports	Imports from Developing Countries	Other Imports	Total Imports
	(percent)					
ISIC <sup>a</sup>						
31 Food, beverages & tobacco	2.4	8.4	10.8	3.4	7.7	11.1
32 Clothing, textiles & leather	7.7	14.1	21.8	8.5	25.1	16.6
321 Textiles	4.2	22.0	26.2	4.3	15.1	19.4
322 Clothing	9.9	4.5	14.4	13.9	15.9	29.8
323 Leather products	9.8	16.5	26.3	11.9	28.1	40.0
324 Footwear	14.8	19.0	33.8	na	na	na
33 Wood products	1.3	8.4	9.7	2.8	12.8	15.6
35 Chemical products	1.8	19.3	21.1	3.5	12.6	16.1
37 Metal products	1.7	35.4	37.1	3.4	17.9	21.3
39 Miscellaneous manufactures	6.7	57.6	64.3	18.0	30.4	48.4

Source: North-South Institute.

a. International Standard Industrial Classification.



**TABLE 6-11 Developing Country Market Penetration, Canada, 1980**

Highest market share (over 5 percent of consumption) in 1980		Fastest growth in market share, 1970-80 (over 20 percent)	
ISIC <sup>a</sup>	Percent	ISIC <sup>a</sup>	Percent
3319 Wood, misc.	37.3	34111 Pulp, pulp products	99.6
3853 Watches, clocks	22.9	3833 Appliances	66.3
32203 Underwear	19.8	32122 Textile bags	48.5
32206 Knitted apparel	18.8	3821 Engines	46.7
38321 Radio, TV	16.3	3841 Ship repairs	37.4
3233 Leather products	16.0	3231 Leather tanning	36.3
38111 Cutlery	15.4	3849 Transport equipment	33.7
32401 Leather footwear	14.8	3319 Wood, misc.	33.6
32111 Cotton fabrics	10.8	3853 Watches, clocks	31.9
32204 Leather apparel	9.0	3844 Motorcycles, bicycles	29.7
32205 Headgear	8.7	38322 Telephone, telegraph	29.2
3901 Jewellery	7.5	35112 Inorganic chemicals	27.6
3610 China	7.3	38521 Ophthalmic goods	26.4
39092 Toys	7.2	38292 Sewing machines	23.8
32122 Textile bags	7.2	38321 Radio, TV	23.6
32202 Women's outerwear	6.3	3901 Jewellery	23.1
3113 Canned fruit & veg.	6.0	32112 Wool	22.9
32201 Men's & boys' outerwear	5.9	39094 Brooms, brushes	22.7
3231 Leather tanning	5.7	38522 Optical instruments	22.3
3844 Motorcycles, bicycles	5.7	3903 Sporting goods	21.4
3903 Sporting goods	5.3	3213 Knitting mills	20.8
32112 Wool	5.1	3540 Misc. petro. products	20.6
		32202 Women's outerwear	20.5
		32113 Synthetic fibres	20.0

Source: North-South Institute.

a. International Standard Industrial Classification.

restraint procedures were initiated against them." Market penetration was presumably even less at that time.

Footwear import quotas now apply to canvas as well as leather and synthetic footwear and they have recently been extended to the end of March 1986. The government has actively sought to replace the footwear import quota with selective "voluntary" restraints for developing countries, so as to give less offence to U.S. and European suppliers. So far, the developing country suppliers, in the absence of any footwear industry equivalent to the MFA authorizing such practices, have not agreed to voluntary restraints.

Canada is certainly not alone in protectionist policies directed disproportionately at the manufactured exports of the developing countries. But neither has it been an international leader in the effort to develop alternatives to increasing protectionism at home, as might be expected from so trade-dependent a country (and as the Netherlands,

for instance, has done). Its domestic adjustment policies are still widely regarded as weak and lacking credibility, not least within the trade union movement which must be won over if the adjustment alternative is to be given a chance politically. In 1978 the Economic Council of Canada recommended establishment of an adjustment fund of \$4 billion for use over a 15-year period, a figure that was probably rather larger than necessary. When the Canadian Industrial Renewal Board (CIRB) was set up in 1981 to provide industrial adjustment assistance, it was only given \$250 million for the textiles and clothing industries and \$17 million for footwear and tanning, available over a five-year period from 1981 to 1986. In April 1984 the Board was given an additional \$90 million for its final two years.

The creation of the CIRB was part of an effort to update the government's 1970 national textile policy.<sup>15</sup> The Industry and Labour Adjustment Program (ILAP), started in 1980, was much more generalized and was associated with a commitment to five more years of bilateral import restraints. ILAP has been slow to start effective programming. Its most recent annual report, covering the 1982–83 period, does not offer enough information for a fair assessment of its progress to date. There are already grounds for concern, however, about the ease with which firms are able to obtain “restructuring” assistance and about the inadequacy of assistance for workers.

Benefits for workers affected by imports have been intended to offer “enriched” mobility assistance and training allowances, portable wage subsidies to encourage re-employment of older workers, early retirement benefits, and job creation measures in designated communities. There have been implementation difficulties and only limited amounts have been spent. Benefits are now to be extended to workers outside the designated communities and to former employees of CIRB-assisted firms. Workers have not taken earlier programs too seriously, because of the severe restriction of benefits. For instance, at one point the early retirement benefits — the principal element in the labour adjustment program — were available only to workers over age 54 who had worked in the affected industries (clothing, textiles, footwear or tanning) for 10 of the previous 15 years and to younger workers with 30 years of employment in the industries and proven financial hardship.

The case for liberal trading policies and better adjustment measures to facilitate an efficient Canadian response to changing international comparative advantage, and indeed to promote stable, equitable and efficient economic development for Canada, is argued in other papers for this Royal Commission. Here it is important to say that not only are Canadians significantly hurt by high protection against developing countries (see, for instance, Jenkins, 1980), but the developing countries are also being *severely* hurt by the increasing resort to non-tariff, administrative, and ad hoc measures, all of which discriminate against those least able to



retaliate effectively. To some degree these countries can redirect their trade, alter the details of their patterns of production, and thereby slip through the growing network of controls. But the increased uncertainty surrounding manufactures exporting activity is very real for them. It is bound to reduce investment in what are clearly areas in which they have a comparative international advantage, and thereby to lower efficiency and probably growth. Ironically, the developing countries face these barriers when, after years of Western exhortation to "look outward," they have finally begun to do so. To the extent that market access can only be acquired through alliances with firms in the importing countries, for instance via subcontracting arrangements in the electronics sector or through sectoral agreements of various kinds, they may also be driven in the short- to medium-run into more dependent forms of international interaction.

The Canadian tariff system has not explicitly encouraged international subcontracting, as far as one can tell, but information is not readily available. For goods with inputs originating in Canada, an order-in-council of 1970<sup>16</sup> authorized application of import tariffs only upon foreign value added, the same provisions as are found in the United States (tariff schedule items 806.30 and 807.00), the EEC and Japan. But there is no public information as to the use of this provision in the case of developing country trade, which appears to have been small.<sup>17</sup> In the United States, imports under this provision amount to about 20 percent of the value of total imports of manufactured products from developing countries. It has undoubtedly contributed importantly to the on-going process of industrial adjustment by permitting the more competitive segments of weak industries to adjust more gradually to import pressure.

The current renewed Canadian discussion of the possibilities of free trade arrangements with the United States (External Affairs, 1983a; 1983b) — whether on a sectoral or a wider basis — should be placed, as it too rarely is, in the context of a careful consideration of the wider multilateral trading scene. It is the essence of such arrangements that they are discriminatory against non-North American suppliers. In some sectors, notably clothing, textiles and steel, developing countries are likely to be significant losers from the resulting discrimination. The formation of such preferential arrangements among Northern countries will (correctly) be seen as further evidence of the erosion of multilateral approaches and a continuing march toward a tiered trading system. While Canada-U.S. free trade may bring about some rationalization of North American industry, this may strengthen the forces of North American protection in weaker industries against more efficient outsiders. At a minimum, such rationalization ought to be conditioned on a firm commitment to standstills on further barriers against exports of third countries. Greater overall rationalization could obviously be achieved by a *non-discriminatory* reduction of high trade barriers in these

sectors in the first instance. If the Government of Canada is serious about its aspirations for the multilateral trading system and at all concerned about its trading interests and political relations with the developing countries, it must analyze more carefully the implications of the trade diversion that will follow the proposed free trade arrangements with the United States. If these arrangements proceed, appropriate compensation will have to be provided to the prospective losers.

As far as policy on primary commodity trade is concerned, Canada has adopted a cautious stance. On international commodity agreements, it has considered the merits of proposed price stabilization schemes on a case-by-case, commodity-by-commodity basis (Ritter, 1978). In the discussions of international agreements for cocoa, coffee, tin, sugar and natural rubber, Canada has typically joined with other importing nations in efforts to hold down the price ranges within which stabilization is sought, tighten supply guarantees, minimize financial contributions and otherwise protect consumer-country interests. In the process it has employed the free-market rhetoric and the relatively weak analytical apparatus traditional in Northern approaches to international price stabilization, and has tended to follow the lead of other importing countries. The one case in which Canada may have been pivotal to the prospects for a successful international commodity agreement was that of copper. In that case, it appears that Canadian policy makers and lobbyists feared that infringements upon the "free market" (in reality, a high proportion of Canadian exports are intra-firm) could reduce Canadian access to its accustomed (U.S.) markets. Nor has Canada been receptive to across-the-board approaches such as the UNCTAD proposal for a Common Fund, although it is now prepared to participate in the more modest fund that has been negotiated.

Little enthusiasm has been shown in Canada for producers' associations — for instance, in copper and iron ore — where interest might objectively have been expected. Australia has taken a far more positive approach to such organizations, participating in the copper, bauxite and iron ore associations. That is not to suggest, however, that the exercise of power in primary commodity markets has never been of policy interest to Canadian governments. Canada's keen official interest in market stabilization schemes in the case of uranium, nickel and potash, not to speak of grains and dairy products, suggest that there is no universal aversion to participation in such arrangements on grounds of principle. Canada has a clear interest in at least staying informed about mineral developments in potentially competitive developing countries, and producer associations can be an important means for doing so.

A major aspiration of Canadian trade policy makers has been to reduce protection in other countries against early-stage primary processing activities. Canada has pushed actively within the GATT for a "sectoral approach" to tariff negotiation, with the object of reducing



tariff escalation on products of particular interest to Canada, notably certain forest and mineral products. Its credibility in such campaigns has been severely prejudiced, however, by its exclusive focus upon primary processing activities relevant to Canadian industrial and exporting prospects, and its continuing substantial escalation of tariff protection against tropical primary products, including even some forest products. Canada has never suggested that protection levels should be lowered in its own primary-processing industries as part of a broader international effort to negotiate sectorally on tariff de-escalation.

On technology imports, services trade, and transnational corporate codes, Canada has cautiously pursued its interests in ways that have generally been interpreted as more sympathetic to developing country needs than, say, U.S., British or German approaches, but there has been little progress in any of these areas as yet. The proposed UNCTAD code of conduct on technology remains bogged down in fundamental North-South disagreement as to its legal status and details of its coverage. The UNCTAD “principles and rules” governing restrictive business practices are a step in a desirable direction but they lack teeth. The UN code of conduct for transnational corporations is also bogged down in fundamental disagreements. The outcome of the debate over the GATT’s treatment of services trade remains to be resolved.

### ***Canada’s Financial Relations with the Developing Countries***

Until very recently, Canada has directed capital to the developing countries primarily through official government-to-government channels. High proportions of these official flows, about 30 percent in the late 1970s and nearly half in 1982, have been provided on non-concessional terms, primarily as export credits. These are much higher percentages than in the OECD overall, as shown in Table 6-12, but official development assistance on concessional terms has always dominated these flows. During the 1970s, as private money and capital markets grew and as aid flows stagnated, financial flows from OECD countries to developing countries were significantly “privatized.” Private commercially-motivated capital flows increased from 40 percent of total OECD flows in the early 1970s, to over 60 percent in the late 1970s. The stock of developing country external liabilities also altered markedly during the 1970s. The share of medium-term commercial bank loans rose from 8 to 27 percent of the total while the share of direct foreign investment dropped from 32 to 20 percent and that of non-concessional debt also fell (Helleiner, 1983). The privatization of Canadian capital flows to developing countries lagged behind the rest of the OECD, but bank lending surged forward in 1980–81. According to OECD sources, the flow of private capital from Canada to the developing countries was severely interrupted in 1982, as

shown in Table 6-13. Direct investment and private export credits turned sharply negative, while net bank lending stopped.

**TABLE 6-12 Major Components of Resource Flows from Canada and the OECD to Developing Countries and the Multilateral Agencies**

	1971-73 (average)	1978	1979	1980	1981	1982
Net flow of private commercial capital <sup>a</sup> as percent of total net flow of resources						
OECD	40	62	63	54	62	55
Canada	41	33	32	47	62	-23
Net flow of non-concessional flows as percent of total net official flows						
OECD	20	21	11	16	20	27
Canada	15	29	28	38	19	48

Source: Organization for Economic Co-operation and Development, *Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, 1983 Review* (Paris, 1983), pp. 182-84, 232, 241.

a. Private direct investment, portfolio investments and private export credits, but not grants by private voluntary agencies.

**TABLE 6-13 Private Resource Flows to Developing Countries from Canada and OECD, 1980-82**

	Canada			OECD Total		
	1980	1981	1982	1980	1981	1982
	(US\$ millions)			(US\$ billions)		
Direct Investment	400	700	-210	10.5	15.7	9.9
Bilateral portfolio investment and other	1282	1800	—	17.2	25.4	23.7
of which: net bank lending	1270	1786	—	17.5	25.3	23.5
Multilateral portfolio investment	1	13	-2	1.5	3.8	5.2
Private export credits	-39	37	-148	11.5	10.5	7.3
Total	1644	2534	-360	40.7	55.5	46.1

Source: Organization for Economic Co-operation and Development, *Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, 1983 Review* (Paris, 1983), pp. 232, 241.



Over the 1970s, a period during which Canada emerged as a net direct investor in the rest of the world, the developing countries accounted on average for 24.2 percent of total gross Canadian direct investment flows abroad. In 1979, the latest year for which there are data, the Cdn\$3,384 million invested by Canadian firms in the developing countries amounted to 17 percent of the total gross stock (about \$20 billion) of Canadian direct investment abroad, 43 percent of this investment in the United States is excluded. Table 6-14 shows that investments are concentrated in the Western Hemisphere. While Canadian investments in the Third World have traditionally been primarily in resource industries and utilities, more recently they have also gone into manufacturing, and the heavy investment in the Caribbean suggests that much investment is also in financial services.<sup>18</sup> Bilateral investment treaties between individual host developing countries and the Government of Canada and, to some extent, the investment insurance program of the Export Development Corporation (EDC), may have helped to encourage Canadian investors in the locations where they have placed significant amounts of capital. Activities of foreign affiliates of Canadian firms in developing countries evidently account for a larger share of the activities of Canadian-based transnationals than do Canadian direct exports to developing countries in total Canadian exports.

**TABLE 6-14 Canadian Direct Foreign Investment  
in Developing Countries, 1979<sup>a</sup>**

	(Cdn\$ millions)
Bermuda	698
Brazil	551
Indonesia	385
Bahamas	257
Jamaica	160
Mexico	105
Argentina	53
Venezuela	49
Hong Kong	25
Trinidad/Tobago	8
Other Caribbean Countries	256
Other Latin American Countries	320
Africa, excluding South Africa	111
Other Asian Countries	265
Unallocated	141
Total, Developing Countries	3,384
Total, World	19,974
Total, World excluding U.S.	7,807

Source: Statistics Canada.

a. Book value

About one-third of foreign lending by Canadian banks has been directed to developing countries. It has been estimated that Canadian banks carried a gross risk exposure to developing countries, including oil exporters, of \$34 billion in mid-1983 — about 14 percent of their total loans or 10 percent of their total assets and about three times shareholders' equity (Brown, 1983).<sup>19</sup> About 70 percent of this exposure was in Latin America and the Caribbean, with Mexico, Brazil, Venezuela and Argentina making up two-thirds of the Latin American exposure. This degree of exposure in vulnerable developing countries is of the same order of relative magnitude as that of the U.S. banking system. On a per capita basis also, Canadian lending to developing countries has been about the same as that of the United States. The Inspector General of Banks has encouraged Canadian banks to make increased provision for Third World losses, required greater disclosure of country exposure (they are now required to reveal country exposure totalling over 1 percent of assets), and encouraged greater uniformity of accounting practices. There have been no publicly disclosed Canadian initiatives with respect to management of the international debt problem.

Foreign aid or “official development assistance” has long been seen as the key point at which Canadian government policy impacts upon the developing countries. As has been seen, this is a serious misperception and is only very slowly being overcome. As far as official development assistance is concerned, the recent Canadian record has been relatively poor. In the latest OECD annual review of development cooperation, Canada is listed as one of only four countries (out of a total of 17) that experienced slow growth or decline in real aid flows from 1976–77 to 1981–82 (1983b, p. 80). (The three others were the United Kingdom, the United States and New Zealand.) Because of the relatively rapid growth in Canadian aid in the first half of the 1970s, the overall Canadian record is still superior to the OECD average in some respects. In 1982, official development assistance made up 0.42 percent of Canadian GNP while the OECD average was 0.38 percent. In grant-equivalents, Canadian aid of 0.39 percent of GNP was marginally greater than the OECD average of 0.38 percent. Canadian performance was, of course, still far below that of the Scandinavian countries and the Netherlands (see Table 6-15), and well below the internationally agreed target of 0.7 percent. In 1980, the government announced its intention of reaching 0.5 percent by the middle of the 1980s (1986) and making “best efforts” to achieve 0.7 percent by the end of the decade. But actual performance can be impeded by donors' own administrative requirements and deflected by all manner of political and economic events — such longer-term targets have not always been taken too seriously. The 1984 federal budget, for example, announced the government's intention to employ “up to one-half of the increase” in future “aid” allocations for the support of Canadian exporters rather than for the traditional development objectives. This



response appears to have resulted partly from the difficulty of “moving funds” in large enough volume to the current aid recipients under existing policy and administrative constraints, and partly from political pressure exerted by exporters. For what these projections are worth, Norway, the Netherlands and Sweden have announced their intention of retaining aid at 1 percent of their GNP; since these countries have already achieved that level of performance, their credibility is significantly greater than Canada’s.

The Canadian record with respect to aid quality is particularly weak. The cost of aid tying has by now been so well-documented that only those with direct interests at stake attempt to defend it. It not only raises costs to the recipient but also distorts priorities, biases techniques inappropriately, raises administrative costs, slows disbursement and makes it difficult to employ aid for rural projects or to alleviate poverty. The percentage of total Canadian aid that is tied to Canadian procurement (64.8 percent in 1982) is the second highest in the OECD, exceeded only by Austria, and is much greater than the OECD norm. Canada also leads all others in imposing tying restrictions upon its contributions to multilateral aid (OECD, 1983b, p. 197).

In 1975 the Government of Canada pledged to untie its bilateral development loans to the extent of permitting developing countries to compete for contracts. Even this modest step has never, in fact, been taken. A recent study of Canadian aid to Bangladesh concluded that tying regulations constitute an important operational constraint on the Canadian International Development Agency’s activities there. They particularly inhibit activities in the rural and social sectors which have ostensibly been priority areas for Canadian assistance. Because untied resources have been reserved for rural activities, projects in other sectors have thus far frequently suffered most from the costs of tying (Ehrhardt, 1983, pp. 127–38). In a similar study of Senegal, the “effectiveness” of CIDA projects proved significantly reduced by the intrusion of Canadian commercial and other interests in their choice and design (Lavergne, forthcoming).

Canada’s current policy is to entrust no more than 20 percent of its aid to the international financial institutions. These institutions, particularly the International Development Association, are known to distribute funds in greater accordance with objective needs than bilateral donors. This places Canada exactly in the middle among OECD countries in terms of multilateral contributions as a percentage of GNP in 1982. Again, performance in this respect is in marked contrast to the Netherlands and the Scandinavian countries.

Food aid, which has always made up a significant proportion of the CIDA bilateral program, is a special category of tied aid that should be treated separately, both because food is such a fundamental requirement of development efforts and because Canada has a clear comparative

TABLE 6-15 Official Development Assistance Performance of Canada and Selected OECD Countries, 1982

	ODA as % of GNP	ODA Grant- Element as % of GNP	Tied as % of ODA	ODA to Least Developed and Other Low- Income	(% of GNP)	(% of ODA)	Multilateral Contri- butions as % of GNP
Netherlands	1.08	1.02	12.9		0.69	64	0.30
Sweden	1.02	1.02	13.3		0.78	76	0.41
Norway	0.99	0.99	20.9		0.73	73	0.41
Denmark	0.77	0.76	20.1		0.59	76	0.36
Canada	0.42	0.39	64.8		0.28	66	0.13 <sup>b</sup>
United States	0.27	0.27	31.5		0.15	54	0.11 <sup>b</sup>
OECD average	0.38	0.38	32.5 <sup>a</sup>		0.21	56	0.13

Source: Organization for Economic Co-operation and Development, *Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, 1983 Review* (Paris, 1983), pp. 80, 189, 191, 197, 205.

a. Simple average of those listed in the table in the source.

b. Canada was below normal and United States above normal in 1982.



advantage in cereals production. Demand for food grains is rising and expected to continue rising in the developing countries, and variation in national production is also rising both in rich and poor countries. World food grain supplies are expected to be characterized both by increasing relative prices, on average, and by greater supply and price instability (International Food Policy Research Institute, 1984). These expectations place a high premium upon the development of an effective world food security system, and particularly one that protects the poorest against the prospect of hunger or even famine. Hunger and famine can and frequently do occur even in the midst of overall food plenty, when particular areas and groups cannot gain access to required supplies. As one of the relatively few large-scale foodgrain exporters in the world, Canada has a major role to play in the development of adequate international food security. Food aid directed at that objective deserves full support. The use of food aid in support of more general development objectives may also be appropriate, but because of its potentially negative incentive effects for the development of local agriculture, it is more controversial and must be more carefully handled (Williams and Young, 1981).

Short-term commercial objectives continue to overlap longer-term developmental ones in many of Canada's approaches to developing countries. This confusion of objectives has been especially damaging to the Canadian aid program, which ostensibly has primarily developmental purposes. Six years after the Economic Council of Canada reviewed Canadian relations with developing countries and recommended that CIDA's pre-investment program be transferred to commercially oriented departments and agencies, the program still resides in CIDA. Despite repeated studies demonstrating the costs to development of tying aid to Canadian exports, and despite recommendations from the Economic Council of Canada and even official promises, Canadian development assistance remains firmly and overwhelmingly tied to Canadian exports. The Canadian record on aid tying is now among the worst in the OECD. There is undoubtedly widespread support — in the business community and more generally — for official assistance to Canadian exporters, and for the activities of the Export Development Corporation (in the developing countries as well as elsewhere). The use of the aid agency to serve commercial purposes at the expense of the objectives that motivated its creation is now formally recognized via the proposed "aid-trade" export fund. This rankles with many of its former supporters in the churches and voluntary agencies. (Adams, 1980b, raises the parallel question of whether the EDC should seek to enter the development business.) This confusion in CIDA objectives, which is much less evident in the Dutch and Scandinavian aid programs, has contributed to public cynicism and erosion of public support not only for CIDA activities but for development-related policies in general.

The degree of public support for effective aid programs is a major element in national aid performance. One measure of this support is the extent of private voluntary giving to the developing countries. The share of GNP directed voluntarily to overseas aid has fallen in Canada over the past decade, as it has in the United States and in the OECD as a whole, as shown in Table 6-16. What is striking is that the OECD countries which lead in official development assistance, as shown in Table 6-15, also lead in private voluntary aid. During the last decade, voluntary aid in the Netherlands and Norway increased significantly as a percentage of GNP. It seems that the good aid performance of the Dutch and Scandinavians reflects a more positive perception of the developing countries than that of the North American public.

**TABLE 6-16 Grants by Private Voluntary Agencies as Percent of GNP**

	1971-73	1982
Netherlands	.027	.079
Sweden	.064	.062
Norway	.044	.071
Denmark	.023	.017
Canada	.055	.043
United States	.062	.042
OECD	.042	.032

*Source:* Organization for Economic Co-operation and Development, *Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, 1983 Review* (Paris, 1983).

There appears to be confusion within the Ottawa bureaucracy as to other aspects of CIDA's performance. An aid agency that engages only in "safe" development projects is unlikely to be doing its job well. A development institution that insists upon precisely the same accounting procedures for its projects in tropical Africa as are applied in Canada will similarly fail to satisfy local needs. Something must be seriously amiss when in the face of the enormous problems faced by the developing countries today, Canadian aid commitments are falling and officials wonder whether they will be able to spend their aid authorizations. The difficulties lie not only in the policy regime that sets the groundrules for Canadian development assistance, but also in the administrative system that determines its daily functioning. The inflexibilities of the Treasury Board's control system frequently necessitate authorizations for even quite small expenditures, generating inordinate delays and consequent inefficiencies and reduced returns. The capacity of CIDA to contribute effectively to development is widely seen, both within its bureaucracy and outside, as seriously and needlessly constrained by costly and unproductive control systems.



Greater flexibility, more risk-taking, larger field staff with decision-making authority up to reasonable limits, longer time horizons and budgeting commitments all would create a more effective Canadian bilateral contribution to overseas development. These are the attributes that make the voluntary agencies, which operate at a much smaller scale, so successful in meeting real needs in the developing countries. It should not be beyond Canadian wit to devise somewhat "looser" arrangements for CIDA expenditures. It is noteworthy that the Canadian aid initiative that probably excites the widest international admiration — the International Development Research Centre — is run on a much "looser" rein than CIDA.

The CIDA strategy for the 1975–80 period is evidently no longer applicable. In any case, independent audits of its performance, weighed against its declared objectives, give it very mixed results (see for instance, North-South Institute, 1980a, pp. 5–18). It is time for a major official review of its objectives and practices, a review to which the nearly completed North-South Institute's detailed study of its recent performance can make an important contribution (North-South Institute, 1983a; Ehrhardt, 1983; Young, 1983; English, 1984; and Lavergne, forthcoming. A summary report will appear in 1984).<sup>20</sup> At a minimum a reformulation of CIDA's objectives should separate its commercially-oriented activities from the development-directed ones. The recent designation of particular aid funds for the promotion of Canadian exports, presumably primarily in the better-off developing countries, may now at least offer the opportunity to designate the *rest* of the aid budget for development purposes correctly and define it more "purely." As a quid pro quo for this commercial "invasion" of CIDA's development functions, the government might now appropriately *remove* the 20-percent limit on bilateral aid flows that can be spent in recipient countries and ease the administrative constraints upon their effective utilization. If some such "balancing" measures are not taken, the development objectives of CIDA are bound to suffer and the broad public base of support for development assistance will continue to erode.

## Conclusions

Canada shares many interests with developing countries in addition to the humanitarian concern of Canadians for international development. Obviously, on some issues, domestic Canadian interests are not as one. The "national interest," after all, consists of some kind of weighted average of the interests of many individuals, firms, groups and regions. Political scientists argue over the actual meaning of "national interest" in practice — the determinants of the weights assigned to different groups in the formation of national policies, the possibility that "the state" has an independent life of its own, and the like. Economists

sometimes simply *assume* that governments pursue a national interest and thereby evade analysis of the divergent interests surrounding alternative national policies. Increasingly, however, theorists of public policy have attempted to identify the demand for and supply of particular types of government policies, and to analyse the economic effects of alternative policies upon different components of the economy.

The most obvious area in which the various Canadian interests in policies toward developing countries diverge is that of trade policy and related industrial policy. Ranged against liberal and non-discriminatory trading policies are the most affected industries, their employees and trade unions, and their political spokesmen. These industries — the more labour-intensive and more mature in technological terms — are largely concentrated in Quebec and Ontario. These provincial governments are therefore also drawn into debates on national trade and industrial policies in support of the interests of their firms and workers. Labour has typically allied itself with industry in protectionist positions, although it is far from evident that this is in its best interests, since government assistance to import-affected firms may generate productivity improvements that displace as many workers as would otherwise have been displaced by imports, leaving the economy less productive overall than it might be. It would almost certainly be to labour's greater advantage if resources equal to those now made available for "adjustment" were to be directed to government assistance programs targetted exclusively or primarily at affected workers and communities. Labour's position may be explained by political calculations that first-best policies are unlikely to be achieved and that in the absence of alliances with industry, there is a risk that they, along with the affected firms, will be "sacrificed" to the national interest in liberal trade. Since credible and carefully costed adjustment policies for workers and communities have yet been developed, such political calculations may well be correct for the present.

Those concerned to maintain liberal international trading policies include importers, consumers, exporters and banks. Importers are rarely of great political importance and consumers are notoriously weakly organized and diffuse in their concerns. Exporting firms and industries are potentially much more powerful political actors, particularly those selling to the countries against which protectionist measures may be deployed. Some provincial governments, notably those of the western provinces, are also particularly averse to measures that simultaneously threaten their growing export trade with the Pacific rim countries and raise domestic prices for goods they do not themselves produce. In recent years, the interests of Canadian banks that have lent to the developing countries seeking to sell manufactures in Canadian markets have become more evident; in order to service their debts these



countries must be able to earn foreign exchange through expanding exports.

The twin challenges before the Government of Canada in its relations with the developing countries are: (a) to develop domestic policies that effectively address the legitimate concerns of affected interests, notably those of labour, as the Third World enters more significantly upon the world stage; and (b) to promote, as a middle power, an appropriate evolution of international economic institutions and arrangements so as not only to accommodate the interests of the emerging Southern powers but, more broadly, to promote a more stable, efficient and equitable global economy for all. In planning for a desirable global future that takes the interests of developing countries and middle powers more fully into account, there is much to be said for initiating consultations and cooperative economic and political arrangements that cut across traditional alliances and trading blocs. Apart from offsetting traditional biases in economic infrastructure, and in patterns of trading and financial links, such arrangements are also likely to reduce the risk of ossified habits of thought. Fresh new initiatives at the international level are as likely to emerge from increased contacts among “middle” members of different blocs — as to some degree they already have in Commonwealth consultations between such varied countries as Canada, New Zealand, India and Nigeria — as they are from deliberations between the Great Powers. Middle powers of the North and the South — those in the “south” of the North and the “north” of the South<sup>21</sup> — should consider the potential virtue and feasibility of allying in their common interest in international economic reform and/or reconstruction. Here is where the interests of Canada and the developing countries most obviously coincide.

As policy issues relating to developing countries assume greater importance — debt rescheduling, IMF conditionality, protectionism and its alternatives in senescent manufacturing industries — Northern governments are already “graduating” their concern with Southern problems from the ghettos of the aid agencies. Global systems maintenance requires more holistic and comprehensive approaches to international economic problems, approaches that adequately address the problems of all of the members of the international community. The developing countries’ main concerns are now systemic ones. But the South appears ready for detailed discussions of specific global problems on an issue-by-issue basis. A real opportunity may now exist for a new beginning in many areas of recent international dispute. What must at all accounts be avoided as these issues are addressed is a further splintering of the global economy into tiers and blocs, with internal rules of their own.

There is at present no effective focal point in the Government of Canada that can deal at an operational level with Canada’s economic

relations with developing countries, or the broader systemic concerns that these countries express. The interdepartmental committee concerned with these matters in the mid-1970s no longer functions, and the mandate of the Department of External Affairs division with responsibilities in this area has been interpreted primarily in terms of the diplomacy of "global negotiations" at the United Nations. In consequence, policy continues to be made in an uncoordinated and ad hoc fashion in various government departments and divisions. The Government of Canada does not now seem organized in such a way as to offer hope for a detailed and constructive response to the challenges before it.

For much of the Third World, the "aid era" is over. The era of North-South confrontation may also be nearing its end. A new era of true multilateralism in the reform and reconstruction of international economic institutions could be at hand. Whether that opportunity is realized will depend primarily upon policy decisions made by Northern governments during the 1980s. By translating its stated aspirations into more effective policy approaches, the Government of Canada might well play an important and constructive role, as it did 40 years ago, in the international economic diplomacy that is again necessary to assure a stable world future.

## Notes

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1. For analytical purposes, it has become customary to group these countries either according to regions or, more usefully, according to economic characteristics. The simplest economic categorization employs per capita income to distinguish the "low-income" (less than \$410 in 1981 dollars, according to the World Bank) from the "middle-income" countries. The World Bank now also distinguishes "lower middle-income" from "upper middle-income" with the cutoff at \$1700 in 1981 dollars (World Bank, 1983). At the lower end of the range, the United Nations has long employed literacy rates, level of industrialization, and per capita income to identify the "least developed countries," now numbering 36. Toward the upper end, categorization has centred on oil-exporting activity (OPEC membership, or net oil exporting, or oil-exporting plus high per capita income) and the export of manufactures. The most frequently employed category of the latter type has become the "newly industrializing countries" (NICs and "near NICs"), although definitions of these groups vary in their detail.
2. Most notably, for instance, in Brandt and Sampson (1980) and Brandt et al. (1983); Cassen et al. (1982); OECD (1983a); Sewell (1979).
3. One simulation of global trade patterns suggests that the welfare losses imposed upon the developing countries by Northern protectionism are roughly equal to annual aid flows! (Whalley, 1982).
4. Notes for remarks by the Prime Minister at the Mansion House, London, England, on May 13, 1975, issued as a press release by the Office of the Prime Minister.



5. See also North-South Institute (1979).
6. SDRs are Special Drawing Rights in the International Monetary Fund. They are used by the IMF and many other institutions as a unit of account. At year-end 1984 one SDR was roughly equal to one U.S. dollar.
7. An excellent account of this diplomatic history may be found in Commonwealth Secretariat (1982b), together with useful suggestions as to how such diplomacy might become more fruitful.
8. The World Bank has sponsored a new series of such studies, at present available in its working paper series.
9. For details of these issues see Commonwealth Secretariat (1982a), and Cline (1983b).
10. In March 1984, in response to protectionist pressures, the United States unilaterally made sharp cuts in the list of items entering under the preferential system for developing countries; no compensation for the resulting trade losses will be offered.
11. For an objective and chilling account of current U.S. policy approaches to international economic policy, see Lewis (1983).
12. The difficulty of acquiring public information concerning the degree of involvement of Canadian business and banks in overseas activities is striking. If, as many now suggest, there is to be increased emphasis in Canada upon international markets, global product mandates, and international business in general, much greater effort will have to be expended on public collection and interpretation of relevant data. If public debate is to be informed and constructive, this information (including such data as there already are) will have to be published rather than secreted away in government memoranda which are often confidential. The quality of Canadian relations with the developing countries, as with other countries, can only be enhanced by greater openness concerning their details. The relative weakness of statistical services in the developing countries places a particularly high premium upon the provision of public information on North-South interactions by Northern statistical agencies.
13. These data come from the Department of Employment and Immigration and were made available to me by the North-South Institute.
14. China, Hong Kong, India, Korea, Macao, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan, Thailand, Uruguay. The information in this and the succeeding sentences is taken from the Government of Canada's reply to the 1983 GATT questionnaire on import licensing procedures. Restraints on Indonesian exports have since been imposed and Bangladesh seems likely to be next.
15. For an assessment, see Pestieau (1976).
16. Canadian goods abroad order, PC 1970-1835.
17. Enquiries within government strongly suggest that there is no systematic record of the usage of this order internally either.
18. For more details, see Langdon (1977), and Adams (1980a).
19. Official data were sought but could not be released. These figures are described as reasonably accurate within the financial community.
20. Another informed and thoughtful study of Canadian aid came to my attention after this paper was substantially completed (Wyse, 1983).
21. I owe this felicitous phraseology to Pollock and Dosman (1983).

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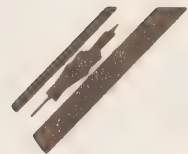
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# Canada and the Future of the Global Trading System

## *Summary of the Proceedings of a Research Symposium*

COLLEEN HAMILTON AND  
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Since 1947 the world trading system has been regulated, more than anything else, by the various agreements worked out among developed countries in negotiations under the framework of the General Agreement on Tariffs and Trade (GATT). In recent years, however, there have been several signs that this system is encountering increasing strains. Member countries have been making greater use of trade measures outside of the GATT framework — particularly quotas, voluntary export restraints and other measures covering textiles, autos, steel and other products. In addition, while GATT rounds have been successful in reducing tariffs, they have been less successful in regulating the use of key non-tariff measures. There is increasing concern about how developing countries can be brought more fully into discussions on the future of the global trading system. There is also concern that bilateral or regional trade arrangements will further weaken the arrangements worked out in the GATT.

In short, the world trade system may have reached a crossroads. While many countries voice support for multilateralism, in some countries it is difficult to generate widespread enthusiasm for another GATT round. Trade policy avenues outside of the GATT framework are being more openly and more widely discussed in many countries.

Canada is no exception. A strong commitment to the multilateral framework of the GATT remains the cornerstone of our trade policies and Canada is committed to exploring the possibility of a future major round of negotiations. However, the proposals made in the summer of 1983 for studying sectoral free trade with the United States imply that Canada too is looking to supplement its multilateral options. Those advocating negotiations on a wider bilateral free trade arrangement with the United

States similarly see the multilateral route as a less promising approach for gaining better and more secure access to our export markets than it was in decades past. These proposals, while not rejecting multilateralism, show a trend toward a balanced multilateral/bilateral approach to our trade policies.

Why does support for the multilateral system appear to be eroding? How can the system be improved so that countries see it as a viable long-term option? If there is another GATT round, what will be on the agenda? And what is Canada's role in the future of the global trading system?

These are some of the questions addressed by the participants (listed in Appendix A) in a research symposium organized by the Research Advisory Group (Economics) on Trade Policy and held on July 24, 1984 in Ottawa. Several participants were invited to present brief papers based on their previous research or experience with the issues, and their presentations formed the basis for subsequent discussion.

Current difficulties with the GATT, and the possible content of a future GATT round were discussed in papers by Michael Aho, from the Office of Senator Bradley in Washington, and by John Curtis of the Institute for Research on Public Policy. Margaret Biggs of the North-South Institute presented a paper on the role of the developing countries in world trade. Similar issues were also addressed by Steven Langdon of the International Development Research Centre. William Diebold, Jr., formerly with the Council on Foreign Relations in New York, gave his views on the growth of managed trade and how the difficulties it raises can be better handled. Views on the same topic were presented by Gerald Helleiner of the University of Toronto. The papers by Aho, Biggs, and Diebold are included in this volume.

## **Current Difficulties with the GATT and Prospects for a Future Round**

In his symposium paper, Michael Aho outlined his views on those issues which will need to be addressed in any future GATT round and the kinds of changes that would be required in the GATT to improve trade relations at the international level.

Aho characterized the international trading system as being in disarray at present, due largely to the poor results of the 1982 GATT ministerial meeting, lack of international discipline on the growing use of trade measures, and increasing domestic pressures for trade restrictions. In his view, the successes and failures of the past should provide lessons from which to build a reformed trading framework, and it is therefore essential to evaluate the reasons for the disappointing outcome to the 1982 ministerial meeting. Aho's view was that the agenda was too long and insufficient work was done beforehand in building a consensus



on what needed to be done. Since that time, the contracting parties have continued to voice their commitment to the GATT while exploring or engaging in new and extended bilateral arrangements outside the GATT framework. In his judgement, this process has served to undermine confidence in the system and little improvement can be expected in the future.

Aho's contention is that long-term structural economic changes worldwide are at the root of current problems with the multilateral trading system. These are manifest in the labour adjustment problems that plague the developed countries and lead to protection outside the GATT framework to stave off the needed adjustments. The political will has been lacking to accept the need to adjust in the long run to changes in the world economy, such as increasing competition from the newly industrialized countries and reduced demand for products of the basic industries of the past, such as shipbuilding and steel.

The situation has been further complicated by a noticeable change in attitudes toward trade relations. There seems to be less belief in the mutual gains from trade and hence in the need to maintain an open multilateral trading system. Instead, we are now witnessing more and more moves toward "zero-sum" trade diplomacy, based on a narrow concept of national interest which downplays the global interest.

In addressing the prospects for a new multilateral round of negotiations in the GATT, Aho questioned whether a new round is the best method for re-establishing momentum for trade liberalization, especially in light of the failure of the ministerial meeting and the less-than-enthusiastic participation of some countries. It may be necessary to examine other ways to move forward, perhaps through a series of negotiating groups on an issue-by-issue basis, and even through negotiations by smaller groups of countries with an interest in particular issues. Also to be determined are which issues are most pressing and need immediate attention and which can be worked on over the medium term.

Aho briefly examined what he considered to be the major issues facing the global trading system, and offered suggestions for ways to move forward. Many of these issues would likely be on the agenda of a future negotiating round if one occurs in the next few years.

**North-South trade**      The developing countries need to be more fully integrated into the GATT. In order for them to service their debt, the debtor countries will have to export more and this necessitates a reduction in the trade restrictions they face in developed country markets. However, such a reduction is complicated by the adjustment problems which the developed countries currently face and which they would face with heightened severity were they to remove their barriers.

**Safeguards and adjustment in basic industries** Aho highlighted the need for a strengthened safeguards code as paramount. He suggested that a surveillance group in the GATT be established to monitor the use of safeguards measures. It could meet on a regular basis, receive reports on new uses of safeguard measures, review existing measures, and act as a forum for multilateral discussions on these issues. He also suggested that any future safeguards code should require adjustment plans to be formally incorporated into any safeguard actions, to help keep such measures temporary rather than the permanent actions they have a tendency to grow into.

**Exceptional sectors** Aho also suggested that efforts need to be made to bring more fully into the framework of the GATT those sectors which had been largely excluded from past negotiations. He highlighted the problems of agriculture, textiles and apparel, and steel, and suggested that a way be sought to gradually reduce barriers under the Multi-Fibre Arrangement and subject the industries involved to greater market discipline. He also suggested that consideration be given to new rules and procedures to deal with problems in the steel sector and other areas where managed trade arrangements are developing.

**Non-tariff barrier codes** Aho asserted that the success of previous GATT rounds in lowering tariff barriers has resulted in increased use of non-tariff barriers (NTBs). He suggested that a broad approach could be to convert all NTBs into tariffs and subsequently to lower the tariffs, a proposal reminiscent of one of the original intentions behind the GATT.

**Trade in high technology products** Aho felt that trade in high technology products would have to be included in future negotiations because the volume of this trade is growing rapidly, as is the use of government subsidies to domestic producers.

**Trade in services** In Aho's view, issues involving trade in services must be part of a future negotiating round. This is now widely seen as a central issue in the United States, and its inclusion is paramount if Congress is to grant negotiating authority for a new round.

**Trade-related investment issues** Like services, trade-related investment issues (regulations linking controls over foreign investment to trade performance) must be included in a future round, in part because this is a further issue which the United States sees as central. Aho's view was that some coverage could be provided by extending existing agreements.



**Counterfeiting and intellectual property rights** According to Aho, if no efforts are made to deal with counterfeiting at an international level, mounting political pressures will lead some countries to take unilateral action.

**Trade-finance linkages** Aho stressed the growing need to examine the interrelations between trade, finance and development issues. Among the issues which need examination are the problems currently facing the debtor countries in the developing world, both in servicing their debts and in facing new trade restrictions in developed country markets. The role of high real interest rates in generating a large capital inflow, a current account deficit, and internal political pressures for protection also needs to be examined. Several papers on these topics appear in *Internal Policies and the External Environment*, volume 13 of the Commission's research series.

**Institutional reforms** Aho identified a number of areas where a series of improvements would help make the GATT system both more responsive and widely respected. Dispute settlement procedures should be strengthened. International transparency in the use of trade restricting measures should be improved. The GATT Secretariat should be strengthened, even to the point of having the authority to set Council meeting agendas, publicize violations, and take the initiative in responding to difficulties as they arise. There should also be a permanent surveillance committee monitoring the global trading system and how it is developing. There should perhaps even be a permanent negotiating committee. Consideration should be given to a multi-tiered GATT system.

Aho concluded by re-emphasizing the difficulties a future negotiating round in the GATT will face, since the focus will inevitably be on improving the entire international trade environment rather than simply reducing tariffs. He also saw more difficulty than in the past in convincing legislators in participating countries to grant the necessary negotiating authority.

In his paper prepared for the symposium, John Curtis contrasted the international cooperation that prevailed in the early postwar years, from which the International Monetary Fund, the World Bank and the GATT evolved, to the fragmentation of recent years. In Curtis's view this fragmentation has even raised doubts as to the continued existence of some of these institutions.

Addressing the reasons for the erosion of support for the multilateral trading system, Curtis focussed on the trade and financial components. On the trade side, he saw changes in both the composition and geographical distribution of world production and trade as crucial. He also noted the importance of exchange rate volatility, in addition to rapid tech-

nological change. Increased discussion of the use of domestic industrial strategies and the possibility of another recession before the end of the 1980s add further pressures on the system. On the financial side, Curtis especially noted the difficulties debtor countries are facing in repaying their debts on schedule, which has brought the international financial system close to crisis on several occasions over the past few years. Complicating the situation is increasing government intervention in domestic economies, leading to disregard for international rules that do not accommodate the domestic strategies chosen.

Despite this erosion and fragmentation, however, Curtis noted that support for multilateralism continues to prevail. In his view, this is due to the overwhelming evidence that as trade restrictions have been reduced, there has been a corresponding increase in trade and financial flows. He saw the multilateral system as especially important for small and middle-sized countries such as Canada, which have benefitted from access to markets that otherwise would not exist for them.

Curtis envisaged a new GATT round occurring in the late 1980s. He indicated items that would likely be included on the agenda as: tariff reductions; liberalization of import regimes of the newly industrializing countries; trade in services, in high technology products and in agriculture; lessening of protection in textiles, clothing, footwear, steel and autos; and strengthened procedures for dispute resolution.

Curtis also laid out his own suggestions for ways to improve the multilateral system. He put particular emphasis on the need for improved consultation and dispute resolution procedures, as well as improved research and analysis capabilities in the GATT Secretariat. Additional recommendations included:

- strengthening codes regulating non-tariff measures;
- concluding negotiations on a strengthened safeguard code;
- phasing-out the Multi-Fibre Arrangement and bringing textiles and clothing under GATT safeguard provisions;
- bringing fisheries under the GATT;
- strengthening rules on state-trading;
- including foreign investment and restrictive business practices under the GATT;
- improving GATT procedures for examining structural adjustment policies;
- integrating the newly industrializing countries more fully into the GATT system;
- transferring some of the activities relating to commodity arrangements, export financing and behaviour codes for transnational enterprises to the GATT from the UN Conference on Trade and Development and the Organization for Economic Cooperation and Development.
- establishing more effective institutional links between the GATT, the IMF and the World Bank.



Curtis also emphasized that if international rules are to have any authority, they must be agreed on through negotiations between a significant number of countries, whose interests have been acknowledged, accommodated and observed in the implementation of any agreements. Given the uncertainty about directions the world trading system may take in the years ahead, Curtis's view was that bilateral initiatives between Canada and the United States should be pursued as complementary to multilateral negotiations.

The discussion that followed the papers by Aho and Curtis began by considering possible directions the global trading system could take. While it was acknowledged that there is continuing support for both the multilateral approach to global trade liberalization and liberal trade rules, the worsening debt situation, continued high unemployment in Western Europe, and limited or negative economic growth in Latin America and Africa were seen as forces acting against the search for a liberal trading order. As Curtis put it, there are scenarios in which "the GATT, new round or no new round, will be of limited relevance."

The prospect of a multilateral trade negotiation in the near future prompted discussion not only of items that might be on the agenda, but also of the enormous difficulties involved in a major round and, perhaps more fundamentally, of who should participate.

One participant cautioned against focussing solely on the next round, since even before it can be organized, governments may take actions bearing on the issues to be taken up later. These actions, both substantively and through the atmosphere they create, may do a great deal to determine what can be accomplished in another round and even what ought to be on the agenda. It was suggested by some participants that another round should be held as soon as possible and that some of the more complex issues should be delegated to special negotiating groups.

Participants also discussed whether negotiations should take place between "like-minded" countries, including the option of bilateral negotiations between Canada and the United States. This would be in response to countries such as Brazil, Mexico and the Philippines, which do not appear ready to consider any new trade round at present. Perhaps there could be a movement back to negotiations among some of the original members who created the GATT.

One participant pointed out that there are serious implications for the less developed countries if they do not participate in a future round and concessions are not extended on an most-favoured-nation basis. He further questioned why the Consultative Group of 18 has not worked more effectively and generated more progress toward a new round.

In response it was noted that the consultative process within the GATT, and in particular the Consultative Group of 18, is more successful than it is generally given credit for, but that more could be done. However, size has proven to be a hindrance. Because of the participation

of the European Community, the Group's effective membership is closer to 30 participants, resulting in a loss of intimacy.

There was a consensus among symposium members on the merits of holding negotiating sessions within the GATT in small groups. It was noted that given the negative reaction from the Europeans on a new round, it is necessary to think in terms of more flexible and possibly even discriminatory arrangements. In this case, middle-power diplomacy could play a role. There may be a number of countries comparable in size and with comparable levels of per capita GNP to Canada (including the Scandinavian countries and Australia), with whom we may be able to establish an agenda reflecting a mutual set of issues on which some progress could be made.

However, while agreeing that flexibility is important, Curtis also asserted that the issue is how to control the trade policy behaviour of large countries without being subjected to too much uncertainty. In his view, the question for smaller countries such as Canada is how much flexibility we should give up voluntarily in order to have international rules that maximize stability, predictability and transparency in the global trading system.

There was considerable debate on the suggestion made by Curtis in his presentation that financial issues be brought into future negotiations. One participant argued that achievements on the finance side could be lost if they are "contaminated" by complex issues on the trade side. Curtis felt, however, that macroeconomic policy issues would not be included and that the focus should be on levels and movements of exchange rates, since they impact directly on the trading system.

Another participant strongly supported tying finance and trade issues together more closely. In his view, the global "macro" context is by far the most important element of the emerging international scene. On the trade side, he suggested that the level of illiquidity and the surveillance of surplus as well as deficit countries must be considered, and not just exchange rate volatility. Again the need to work in small groups on both financial and trade issues was emphasized.

Another participant argued that the linkages between trade and finance raise three major issues.

**Debt** In this participant's opinion, without some GATT control over debt problems, meaningful trade liberalization involving the developing countries simply will not occur. The trade ministers in the developed world may need to delay IMF packages or even in some circumstances block them, in order to pry necessary concessions on trade liberalization from countries like Mexico and Brazil. He contended these countries have a long way to go in liberalizing their trade policies, and what they are able to do will be very useful to their own internal economic



performance as well as to developed countries which have difficulty in penetrating these export markets.

**Exchange rate volatility** The participant noted that conflicting views now prevail on both the importance of exchange rate volatility for trade policy and how to deal with it, but that this pattern could continue for some time, especially if there is no speedy action on the large deficits of the United States.

**Persistent misalignment** In a world where capital flows are large in relation to trade flows, this participant's view was that the next round will have to deal with the problem of current account imbalances such as those now occurring in the United States. If this is a systematic problem, it raises the possibility of legitimizing general subsidies on exports in the GATT, as well as implementing broader balance-of-payments measures to deal with these problems.

Finally, the role of central banks and how to make them accountable for their monetary policies was raised in the discussion. However, it was widely felt that these issues go far beyond the type of regulation of global trade that the GATT system could ever accomplish.

## **Developing Countries and World Trade**

In the second session in the symposium the role of the developing countries in the global trading system was discussed. In her symposium paper, published in this volume, Margaret Biggs elaborated on why the less developed countries (LDCs) have been the strongest opponents of recent proposals for a new GATT round and yet have become some of the staunchest supporters of the "old trading order" in the past few years.

Biggs stressed that not only are there large differences among the less developed countries, but their participation in the GATT is far from uniform. However, they share a common perception that they have had little influence in the shaping of the postwar international trading system and have not reaped benefits from it equal to those which have accrued to the developed world.

The importance of the LDCs to both the world economy and the global trading system was emphasized. Not only is there concern about the impact of balance-of-payments and debt-servicing difficulties that many are experiencing, but some of the developing countries have in fact become major trade partners for certain developed countries. There is therefore a shared concern about market access and protectionism. Biggs reported that 45 percent of Japan's exports and 35 percent of the United States' exports currently go to developing countries.

In discussing how the developing countries operate within the GATT, Biggs reported their dissatisfaction with the GATT's ability to serve their

interests. The results of the Tokyo Round were disheartening for them, especially since the Tokyo Declaration in 1973 had set out the interests of the developing world as a top priority. Particularly disappointing was the failure to strengthen the safeguards code and the growing pressures for selectivity against the less developed countries, such as in textiles and steel. Yet despite these drawbacks, Biggs argued that generally the LDCs feel that it is in their interests to support a rules-based trading order within the GATT, and especially the basic principles of most-favoured-nation treatment, predictability and transparency.

The LDCs have been reluctant to endorse any specific proposals for a new multilateral round of negotiations within the GATT. This reflects a concern that preparations for a new round will either “overload” the system or divert attention away from such difficult, unresolved items as safeguards, agriculture and textiles.

Biggs also commented on unfinished business from the Tokyo Round on the GATT agenda, as well as proposed new items of interest to the developing countries. She noted that the safeguards issue, including the use of safeguard measures covering textiles and clothing, remains of greatest concern to the LDCs. Experience under the Multi-Fibre Arrangement has made the LDCs wary of the restrictive nature of any selective solutions, and there are major concerns that trade will be “managed” in other sectors.

However, services and trade-related investment issues were identified as the agenda items that might impact most directly on the LDCs. The LDCs are concerned about losing control over such key service sectors as banking, finance, transportation and communications. They are further concerned that the services proposal seeks to liberalize the international movement of capital but not of labour.

Biggs reported that the developing countries believe the trade-related investment issue as usually stated is too narrow in scope. They would prefer that the issue continue to be discussed in the UNCTAD, and ultimately through a UN code on transnational corporations.

Biggs also discussed proposals for “graduation” and reciprocity on the part of the LDCs which would involve reductions in their protection in any multilateral trade negotiation. She pointed out that many of the advanced developing countries have been moving toward liberalization of their import regimes for some time. However, she felt that further trade liberalization in the LDCs must be considered in the context of the financial crises now experienced in those countries.

In discussing Canada’s trade policies toward developing countries, a number of features that adversely affect the LDCs were raised. As examples, Biggs cited features of the tariff structure that do not favour labour-intensive manufactures and raw materials; bilateral restraints against textiles and clothing; special restraints on footwear; and even



Canadian dumping and subsidy legislation. She also identified areas in which Canadian and LDC interests coincide. These include trade-related investment issues and a strong mutual interest in a healthy, rule-oriented world trading system.

Steven Langdon's presentation focussed on two themes. First, in his view, it is important to see trade matters involving developing countries in the broader context of Canadian economic policies toward developing countries in general. While not downplaying the importance of the potential role of the GATT for the developing countries, Langdon noted that issues such as commodity trade and stabilization of commodity prices, which are of highest priority to some of the poorest countries such as those in Africa, have traditionally been dealt with outside the GATT. In Langdon's opinion, Canada has the capacity to act on these concerns not only directly but also indirectly as a member of the Group of Ten, the IMF and the World Bank. He also agreed on the need to link financial issues and trade concerns.

Langdon's second theme was the importance, from an analytical standpoint, of making a distinction among the developing countries, especially in approaching their trade-related issues. He suggested distinguishing four groups of countries:

**The Asian NICs** This group includes Korea, Singapore and Hong Kong. These are countries that have adopted internal restructuring strategies and are ready to respond to new negotiations on protection. For these countries the GATT can be important, but graduation from the Generalized System of Preferences is also important, as are debt and transfer-of-technology issues.

**India, China, Pakistan** These are large countries that have built a significant industrial base but have accomplished this by a strategy of import substitution followed by selective export promotion. In Langdon's view, a GATT round could be especially significant to these countries if it addressed their allocation of market shares under quota arrangements such as the Multi-Fibre Arrangement.

**The African primary producers** These countries have been the most seriously affected by the macroeconomic crises of recent years. Of particular concern are commodity prices and the stabilization of revenue flows from commodity sales. Langdon saw a GATT round as having little to offer these countries. More important are issues raised by a Common Fund and World Level Stabex.<sup>1</sup>

**The Latin American debtor countries** Langdon could see no mean-

ingful participation in a GATT round for this group of countries until debt problems are resolved. The link between trade and financial issues is so crucial here that unless it is addressed there is little for these countries to negotiate on.

In the discussion which followed, major attention was focussed on how to deal with the LDC debt problem. The suggestion of large-scale debt forgiveness was opposed by one participant, who cited two undesirable effects of such a move. First, the impact on U.S. banks would be so severe as to create a real financial problem in the United States. Second, the banks would have less incentive to provide loans in the future if they were subsequently to be forgiven. In his view, these considerations suggested the need to find another way out of the debt problem.

Another participant saw three further elements as compounding the situation. To start with, debt service ratios are very high in Latin America. Also, the decrease in U.S. exports to Latin America has been fuelling increased protectionism in the United States. In addition, high interest rates and an overvalued U.S. dollar further contribute to increased protectionism. There has also been the imposition of steel quotas in the United States. In addition, it was noted that with the absence of selectivity in safeguards measures used abroad, LDC penetration of our export markets is causing Canada major problems, especially in steel.

There was limited agreement as to the effectiveness of current IMF programs in dealing with the debt situation. In one participant's opinion, some IMF programs may be too severe in the short term and not severe enough on the longer-term structural issues.

Subsequent discussion centered on Langdon's remark that Canada would have to accept more structural adjustment in moving toward a new GATT round if it is serious about trying to include the LDCs. In reacting to this, one participant pointed out that many adjustment problems have also arisen from trade between developed countries, particularly in the case of Japan. Moreover, the differing rates of recovery from the recession across countries has been making adjustment difficult.

Another participant observed that it is not so much a question of developed versus developed or developed versus developing. In his judgement, the main problem in Canada and the United States is internally-generated structural adjustment pressures. As a solution he suggested that there should be coherent adjustment policies, whether they are necessitated by trade or other pressures.

There was some support for reducing import barriers for some countries for balance-of-payments purposes, as a method of liberalizing trade



of debt-ridden countries. This was done in early GATT rounds and worked out reasonably well over the long run. One participant pointed out that this could be a way out of the graduation issue, but he cited two major difficulties. The industrialized countries would have to give substantive concessions now, knowing they would not be reciprocated right away. There would also be discrimination between the seriously indebted countries and those less seriously indebted.

Concerning Canada's reputation on the world stage as a country sensitive to the concerns of developing countries, one participant observed that this view was primarily linked to the positions of some prominent Canadian politicians and, strictly speaking, was not warranted by our policies toward developing countries.

Contrasting with this view was the observation of another symposium participant that Canada shares a common perspective with the developing countries on investment issues. In addition, Canada has been cooperating with them on trade in resource products and sharing information on problems such as tariff escalation, as well as trying to get them to initiate discussions in Geneva.

In his concluding remarks, Langdon agreed the debt issue is crucial but suggested that debt forgiveness or long-term debt rescheduling should be considered for some countries (such as Argentina, Chile and Uruguay), given their burden of debt servicing. On the issue of LDC protectionism, he saw a need to make the distinction between what is happening in Asia and what is happening in Latin America.

In concluding the session, Margaret Biggs stressed that as yet the developing countries did not feel there was anything on the negotiating table for them in the GATT. Canada and the United States should be more aware of the importance of the developing countries, as they have the fastest growing economies. Moreover, the developed countries' own protectionism against developing countries is costly to consumers in their own countries, and she suggested that now is the time for them to take on domestic lobbies and get their own houses in order.

## **Managed Trade**

In the final symposium session, on cartelization and managed trade and the problems these create in terms of quantitative restrictions, William Diebold Jr., formerly of the Council on Foreign Relations, New York, offered some suggestions on how to improve ways of dealing with the difficulties these issues create. The paper is published in this volume.

Diebold briefly discussed the origins of the term "managed trade," which he felt is as much a misnomer as "free trade." He pointed out how unlikely it is that a significant portion of international trade could be

effectively managed, in the sense that it is controlled in order to achieve specified objectives.

Diebold discussed three categories of managed trade. The first type was defined as trade managed by enterprises, or cartels. He felt the problem of cartels has not been serious in the postwar trading world, despite a lack of strict international measures to restrict them. The second case was defined as trade managed by a single national government. In Diebold's judgement, whenever a national government tries to influence the volume of exports or imports, their composition or price, it is in effect attempting to "manage trade" — especially when such an effort is comprehensive or part of a development plan. Lesser efforts cover many activities that may be thought of as ordinary trade policy. Trade managed by two or more governments working together constituted the third category identified. This type most often arises when international rules or procedures either do not work or are not adhered to, and often results in agreement between governments about the amounts of goods to be traded and sometimes the price range.

Diebold reviewed the experience with managed trade outside the GATT framework, particularly through commodity agreements and trade in agriculture and textiles. He then looked at more recent forms of managed trade in steel and autos.

In Diebold's view, commodity agreements have not proved to be of lasting significance. If anything, they tend to support the argument that management of this sort is not viable on a long-term basis. In agriculture, as an example, international trade patterns stem from the farm policies followed by most developed industrial countries. Actions taken by the United States under a GATT waiver and by other countries without such sanction have resulted in a series of managed domestic agriculture policies and in internationally disorganized trade in agricultural products.

Trade in textiles, governed by complex new trade rules involving negotiations between exporting and importing countries but with limited multilateral surveillance, has produced mixed results. While some jobs have been saved in the textile industries of Europe and North America, and trade in textiles has expanded, one could hardly speak of an "orderly transfer" of those parts of the textile industry best suited to low-wage countries. Instead, textile producers in developed countries have resisted new competition from imports, and restraints on foreign trade have generally been tightened. No one is eager to produce an agreement similar to the Multi-Fibre Arrangement for steel or autos, and yet the recent experience with steel seems to suggest that this is the direction in which the global trading system is moving.

Diebold reported that voluntary export restraints (VERs) and orderly marketing arrangements (OMAs), particularly with respect to Japan,



have been in effect since the 1950s and 1960s. In his view, VERs will continue to exist and are likely to be an integral part of any widespread movement toward managed trade. With this in mind he suggested that more in-depth analysis should be done on VERs, from economic, political and diplomatic standpoints.

Commenting on current arrangements in steel and autos, Diebold raised a number of general questions on the issue of managed trade and in particular the role Japan has played in the evolution of these arrangements. He was doubtful that the old basic industries of steel, textiles and autos are the last that can elicit a protective response from European and North American industry. Moreover, he also doubted that other Asian countries or newly industrializing countries will be as accommodating as Japan has been in negotiating trade restraints.

Diebold offered a series of proposals for improving the handling of the issues that managed trade raises. Among these were:

- strengthening the GATT by improving the application of existing rules, improving the safeguards clause, subjecting OMAs and VERs to comparable rules, and bringing performance requirements and related investment matters into the GATT;
- dealing with structural adjustment problems, either through the GATT or elsewhere;
- continuing consultation on problem areas and issues that can be anticipated in advance, and devising prospective policies to deal with them; and
- using wider consultation when special problems arise, and discussing the best manner in which to deal with each case from a wider perspective than simply national or sectoral interest.

Diebold also noted that if managed trade arrangements could be judged by their results rather than by the form of action taken, this might help to bridge differences in ways of proceeding between countries. In Diebold's view, transparency and some degree of international surveillance would be required to improve the present situation. He stressed that he did not see the aim of a consultative process to be drawing up a tight set of rules governing managed trade for each affected industry, as this could create a series of special situations, each similar to that in textiles.

Finally, while emphasizing the need for the international trading system to be governed by the principles of the most-favoured-nation clause, Diebold recognized the need to permit managed trade arrangements to be worked out among limited numbers of countries. However, he stressed that these arrangements should be consistent with the broad principles and objectives of multilateral cooperation in trade and should take account of the interests of non-participants in such arrangements.

There was little disagreement with the comments made by Diebold. In

his remarks, however, Gerald Helleiner elaborated on several points. He cited the long history of sector-specific managed trade in other spheres, such as cocoa beans and copper, which were characterized by a large degree of "flexibility." However, he noted that international primary commodity agreements were subject to rules under which consumers were given voting power equal to producers in the decision-making process. Helleiner also drew attention to the links between investment and managed import trade. In these cases, threats of domestic content legislation are employed to generate "voluntary" increases in foreign investment. Again there are no rules and little transparency, creating the potential for investment wars.

Given the emphasis on oligopolies, market imperfections and scale economies in recent theoretical literature, Helleiner also questioned whether the time has come when problems may also arise with cartels. If this is true, perhaps more work should be done on international restrictive business practices, especially given the potential consumer losses involved. Helleiner, like Diebold, stressed the need for wider participation and consultation on these issues. He also saw a need for a strengthened international capacity for research and data collection, perhaps in the form of a strengthened GATT Secretariat. He saw this as especially important for the LDCs and for newcomer countries to the GATT.

One participant asked what course of action to take as regards managed trade. On the one hand, one may want to get rid of it in light of evidence which suggests that quantitative restrictions, orderly marketing arrangements and the MFA have been less restrictive than portrayed and a number of countries have found ways around them. On the other hand, one may want to support "creative foot-dragging", due to the persistent adjustment problems in vulnerable industries such as textiles. In these cases, slow adjustments may be preferable to an overly abrupt change in policy which could lead to increased pressure for protection.

Another participant drew attention to the close relationship between the managed trade issue, and safeguard and adjustment issues. In his view, the fundamental problem is that people are not prepared to confront the domestic consequences of a more adequate safeguard system.

He also found it curious that exporting countries find it in their interest to go along with voluntary export restraints, rather than forcing the issue by making importing countries institute visible import barriers. Michael Aho responded that the Japanese were doing very well as a result of voluntary export restraints that they generally permit exporters to get higher prices for their products, and that the only people who do not like VERs are newcomers excluded by restrictive trade agreements and economists. Another participant also noted that there is a need to distinguish between Canadian interests and global interests when con-



sidering managed trade. In his view Canada has gained from voluntary restraints on Japanese cars in U.S. markets.

While William Diebold agreed that there can be advantages to other parties from particular episodes with managed trade, he cautioned that one managed trade arrangement often leads to another, which may alter the balance of advantages relative to the initial measure. Finally, he pointed out that in managed trade, as in other trade or industrial policy, the traditional emphasis on national interests often conceals major conflicts of interest within each country, as well as obscuring the interest of all countries in having a well-functioning system of international cooperation.

## Summary

Discussion during the symposium touched on a wide range of topics. A few central themes clearly emerged.

While there was unease about the way the multilateral trading system has been functioning of late, there was also general agreement that a new GATT round could occur in the late 1980s. The most likely items on an agenda were agreed to be services, agricultural trade, safeguards, investment issues, and the need to integrate the developing countries more fully into the GATT system.

Most participants saw the need for improvements as a necessary part of the on-going evolution of the multilateral system, and emphasized that a new round will be as much concerned with re-invigorating the global trading system as with new reductions in trade barriers. Safeguard improvements emerged as the most important issue to be dealt with, either individually or in conjunction with the adjustment issue. There was widespread agreement that the GATT Secretariat needs strengthening, even to the point of having the power to initiate actions against offending parties. There was also a consensus on the need for improved interaction between the GATT, the IMF and the World Bank.

With the less-than-enthusiastic support from some countries for an upcoming round, there was speculation on what might be the shape of the future international trading system. Several participants voiced support for negotiations between like-minded countries, perhaps leading to a multi-tiered GATT system. At the very least, there seemed to be an apparent need to work and negotiate in smaller groups.

Much discussion during the day also focussed on the interrelationship between trade and finance. Discussion was polarized between the need to tie the two related systems more closely together and the need to separate them because progress on trade negotiations could be slowed

by the more complex issues of coordinating macroeconomic policies.

Throughout the symposium there was an underlying feeling that there is a delicate balance between success and failure in a next round. How the future global trading system evolves could depend on which way the balance tips, and Canadian interests will be very much affected.

### *Note*

1. World Level STABEX is the system to guarantee the stabilization of earnings of African, Caribbean, and Pacific states from exports to the EC in the selected products on which these economies depend.



## Appendix

### List of Participants

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#### RESEARCH SYMPOSIUM ON CANADA AND THE FUTURE OF THE GLOBAL TRADING SYSTEM HELD BY THE ROYAL COMMISSION ON THE ECONOMIC UNION AND DEVELOPMENT PROSPECTS FOR CANADA

Ottawa, July 24, 1984

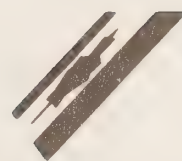
Raymond Ahearn	Congressional Research Service, Washington
Michael Aho	Office of Senator Bill Bradley, Washington
Harvey Bale	Office of the United States Trade Representative, Washington
Margaret Biggs	North-South Institute, Ottawa
Peter Cornell	Economic Council of Canada, Ottawa
David Cox	University of Western Ontario, London
John Curtis	Institute for Research on Public Policy, Ottawa
William Diebold, Jr.	Council on Foreign Relations (retired), New York
Anthony Halliday	Department of External Affairs, Ottawa
Richard Harris	Queen's University, Kingston
Michael Hart	Department of Transport, Ottawa
Gerald Helleiner	University of Toronto, Toronto
Gary Hufbauer	Institute for International Economics, Washington
Andrew Klymchuk	Department of Regional Industrial Expansion, Ottawa
Steven Langdon	International Development Research Centre, Ottawa
Roy Matthews	Economic Council of Canada, Ottawa
David Paterson	Department of Regional Industrial Expansion, Ottawa
Alfred Reifman	Congressional Research Service, Washington
Ronald Shearer	University of British Columbia, Vancouver
Randy Spence	Department of External Affairs, Ottawa
Denis Stairs	Dalhousie University, Halifax
John Weekes	Department of External Affairs, Ottawa
John Whalley	University of Western Ontario, London, and the Royal Commission, Ottawa
Gilbert Winham	Dalhousie University, Halifax, and the Royal Commission
Ronald Wonnacott	University of Western Ontario, London

#### From the Royal Commission

Albert Breton, Commissioner  
Jacques Bédard  
Victor Clarke  
Lilla Connidis  
Colleen Hamilton  
Roderick Hill  
Anne Martin  
Alan Nymark  
Jack Quinn  
David C. Smith







## What Changes Are Needed at the International Level for Improving Trade Relations?

C. MICHAEL AHO

The international trading system is in disarray. The ministerial meeting of the General Agreement on Tariffs and Trade (GATT) in November 1982 was an extreme disappointment and the system has been regressing ever since. International discipline is lacking and a full-scale trade war is not a remote possibility.

Pressures for trade restrictions abound because of current unemployment problems, and will increase because of the labour adjustment problems inherent in the new technologies and heightened international competition. In my opinion, the next few years will be a critical juncture for the trading system. This paper is an elaboration of the major issues and questions which need to be addressed in the debate surrounding a possible new round of multilateral trade negotiations and the future of the trading system.

Ideally, if we were given the task of devising recommendations for improving trade relations, the best way to begin would be to assume that no international trade rules were in place and that the GATT never existed. What system should be developed to take into consideration today's realities in order to promote certainty and predictability and to minimize risk for traders and investors?

That question has been addressed by numerous authors and organizations that have put forward comprehensive proposals for reform of the trading system.<sup>1</sup> But rules, though imperfect, do exist and they have influenced behaviour both positively and negatively. The present system must necessarily be taken as a point of departure. An examination of past successes and disappointments can be instructive. The successes include the major rounds of negotiations (Kennedy and Tokyo) and the general sense of international obligations and responsibilities that the

system has engendered. The disappointments include the non-tariff barrier (NTB) codes of the Tokyo Round, the failure to agree upon a safeguards code, and the 1982 ministerial meeting of the GATT.

The most recent disappointment is perhaps the most instructive. The 1982 ministerial meeting, the first in nine years, suffered because the agenda was too long and there was not sufficient consensus on what needed to be done. Although preparations began almost a year in advance, there were still a multitude of disagreements to be resolved when the ministers arrived in Geneva. The draft communiqué was laden with bracketed language. Also the United States, in its role as an initiator, did not have a consistent strategy for obtaining a strong communiqué. The two political "bottom line" issues for the United States — agriculture and services — did not lend themselves to a single negotiation because the European Community opposed agriculture and the developing countries opposed services.

The agenda for the ministerial meeting included dispute settlement procedures, a safeguards code, agricultural trade, textiles and clothing trade, services, trade-distorting investment practices, trade in high technology products, counterfeiting, North-South trade initiatives, export credits and the effects of exchange rate fluctuations on trade. The results were disappointing. Dispute settlement procedures were refined and improved. Safeguards principles were enunciated but additional negotiations were scheduled. An agricultural committee was established. Services, counterfeiting, textiles and exchange rates were subject to further study. The Tokyo Round codes were to be reviewed to determine their adequacy. Trade-distorting investment practices and trade in high technology products were dropped.

Although the worldwide recession made it a poor time to strengthen international trade cooperation, at least the contracting parties continued to reaffirm their commitment to GATT principles and practices. In the interim, however, new and extended bilateral circumventions have continued to undermine confidence in the system. The future does not look much better. The economic outlook is for continued slow growth, and the pace of structural change will not slacken and may accelerate during the rest of the 1980s.

Although our current problems are certainly exacerbated by slow economic growth, they are more fundamentally caused by long-term changes in the structure and operation of the world economy.<sup>2</sup> The convergence of industrial structures among the developed countries, growing competition in many sectors from the developing countries, and continued rapid technological change all heighten the need for flexible and efficient adjustment to economic change. Political resistance to these changes is likely to spill over into growing domestic and international conflicts on trade and trade policy. Indeed labour adjustment problems are likely to be the paramount political problem of this decade



and the next. The conflict between the need for economic adjustment and the political pressure to erect obstacles to adjustment will continue and probably intensify in the future.

Even without the pressure from future adjustment problems, policy makers are already beset by international economic conflicts on almost all fronts. Disputes among trading partners over specific policies are neither new nor particularly worrisome. What is unusual and troublesome about trade problems today is that they escalate quickly into highly politicized issues involving "zero-sum" diplomacy. Increasingly, trade policy is viewed as a strategic game in which national economic gains can only be reaped at another's expense. This view is in sharp contrast to the postwar perspective that trade provides mutual gains to trading partners.

The shift in policy perspective has a number of causes. The process of world economic integration has made our economies increasingly interdependent and sensitive to interventions abroad. Increasing interdependence and, some would argue, increasing policy intervention have made the distinction between domestic and foreign economic policies obsolete. Ostensibly domestic policies directed at taxes, agriculture, regional development or investment can have as large an impact on international trade flows as tariffs or quotas. However, attempts to deal with the trade effects of domestic policy are viewed as infringements of sovereignty and thus quickly become politicized. This political pressure and the widespread use of bilateral circumventions of the GATT rules have combined to undermine the credibility of the trading system.

Concrete proposals for future progress on the most pressing trade issues are necessary in order to begin to restore confidence in the fairness and efficacy of the trading system. Currently the developed countries, in the context of the OECD, the Quadrilateral and the Summit, have been discussing the possibility of a new round of multilateral negotiations. Some developing countries have also expressed interest at the recent trade ministers meetings in the Far East, Washington and Rio de Janeiro.

There still remains much disagreement among countries on the timing for a new round (some do not even want one) and on the content of any new multilateral negotiation. Several questions need to be addressed. Is a new round of multilateral negotiations the best method to reestablish momentum for trade liberalization? Can sufficient international consensus be developed? In the absence of negotiations to liberalize trade, the system may regress further. In the past, the rounds of negotiations have provided a framework for organizing the political will to reduce barriers. But would a new round raise unattainable expectations? Such an effort could be counterproductive, since failure could undermine existing arrangements which still make an important contribution to orderly international transactions.

What prerequisite steps are needed to ensure that a new round can be mounted effectively? Some countries are arguing that the GATT Work Program constitutes adequate preparation for a new round. Are there issues upon which significant progress can be made, or will any agreement just paper over differences and not be workable? How soon should the negotiations begin? What should be the trade-off between wanting as many countries as possible to participate and wanting to avoid lengthy delays in starting the negotiations? To be truly multilateral, several of the major developing countries will have to agree to participate.

Even if it could be agreed that a new round of multilateral negotiations would be a constructive step, what the round should focus upon would remain a subject of disagreement. The problems affecting the trading system are manifold and everything cannot be done at once. The 1982 ministerial meeting demonstrated the problem of trying to tackle too many things at once. What are the most important issues on which progress is needed immediately, and which issues or institutional reforms should be worked toward over the medium term?

Questions abound. Where should the emphasis be put in any new round? How much should be done to shore up the deteriorating foundation of the GATT? To what extent should the GATT be expanded to cover new activities and practices not covered adequately by existing rules? How much emphasis should be put on integrating the developing countries into the GATT system, with all the rights and responsibilities that entails? How can trade, finance and development issues be addressed in a more systematic fashion which takes account of the interrelationships among them? What institutional changes could be made to improve trade relations and make the system more responsive to emerging problems? Finally, how can the GATT system be made more rule oriented, with greater discipline and procedures which are respected?

What follows is a breakdown of the major issues, a subset of which might comprise the agenda for a new round.

### **North-South Trade<sup>3</sup>**

More emphasis needs to be put on integrating the developing countries into the GATT, with all the rights and responsibilities that entails. Should North-South issues be a major focus of the new round? Does the debt crisis provide an opportunity to engage in substantive trade negotiations on a North-South basis? Resumption of normal export growth by the heavily indebted countries is a necessary condition for them to continue to service their debts. Indeed, even a standstill on new trade restrictions vis-à-vis the developing countries may not be sufficient for many countries to service their debt and resume normal growth rates. A rollback of trade restrictions would be desirable and, in fact, may be necessary.



The developing countries, particularly the upper-tier newly industrializing countries and the OPEC countries, have been the most rapidly growing markets for developed country exports, and they still have vast pools of unemployed or underutilized resources. Both developed and developing countries should be interested in access to each other's market. Recent analyses have pointed out the complementarity of developed and developing country trade.<sup>4</sup> If negotiations could result in reciprocal bargaining, both sides would benefit and the world economy would receive the growth stimulus it so badly needs.

Unfortunately, the problem facing the developed countries is that they have many sticks but few carrots to encourage the developing countries to negotiate. There is some scope for tariff cuts where tariff structures are escalated on processed products. However, the adjustment problems in developed countries are most pronounced, and the political power is greatest, in those sectors in which the developing countries are most competitive.<sup>5</sup> In the absence of concessions by the developed countries in those sectors (which could realistically only come after steps have been taken to ameliorate the adjustment burden for workers in the affected industries),<sup>6</sup> such negotiations may never get off the ground.

On the other hand, what commitments would the developing countries be willing to make in order to carry out their joint responsibility with the developed countries to increase world economic growth? Developing countries still retain high levels of protection in many capital-intensive industries, which could be phased out over time. Negotiations could also encourage the developing countries to rely more on market forces in allocating resources within their countries over time. One troublesome issue will be how any new initiatives will affect "special and differential" treatment. Will graduation be part of the package for the more advanced developing countries and will special policies be necessary for the least developed countries?

## **Safeguards and Adjustment in Basic Industries**

This is the most important unfinished business left over from the Tokyo Round. Can a workable code be negotiated so that the difficult industrial problems which are now most often dealt with through bilateral circumventions can be addressed on a multilateral basis? Should safeguard actions under a new code be only on a non-discriminatory basis or could limited selectivity with notification, consultation and surveillance be adopted?

The current safeguards negotiations appear to be stalemated. What may be needed is an approach which could, at the first stage, bypass the theological dispute over whether safeguard actions should be global or selective. If a surveillance group were established in the GATT, the group could meet regularly and receive reports on new safeguards measures (of

all kinds) and also review all existing measures. Achieving transparency would be the first objective. Then the group could act as the forum for multilateral discussions. As the group amassed experience in dealing with particular cases, a common viewpoint, transcending the varying national issues represented in the group, would hopefully emerge.

After the group has some experience, negotiations could be conducted for a more permanent agreement which would have as its objective a code with provisions for transparency, coverage, degressivity and time limits. The absorption of the so-called "grey area" measures into the GATT system should also be a priority in any new agreement.

In addition, more emphasis should be put on structural adjustment internationally, perhaps by requiring adjustment plans as part of any safeguard actions. The mandate of the surveillance group could be expanded not only to determine the legitimacy of safeguard actions but also to monitor them to ensure that adjustment plans are being followed and that time limits and degressivity are being met. If this were done, a major improvement in trade relations might be achieved, if countries abide by the strictures set up by the surveillance group rather than avoiding the process as they now do in the case of Article XIX. The GATT is the logical place to have multilateral discussions of structural adjustment in basic industries and such an arrangement would facilitate multilateral discussions.

## **Exceptional Sectors**

Agriculture has been an exception since the U.S. waiver was granted in 1955. The basic issue is how to bring the rules for agriculture more into conformity with those for trade in industrial products. Can agriculture be treated on the same basis as industry? Can a better understanding be achieved on limiting export subsidies? What can be done to reduce the large agriculture surpluses that are being generated in some sectors? What can be done to improve cooperation on agricultural trade issues in general? The establishment of the Committee on Trade in Agricultural Products in the GATT has provided a forum for multilateral discussion of agricultural trade problems, but it remains to be seen if it will have a lasting effect and if progress can be made.

Textiles and apparel have been under a restrictive regime for over 20 years. What began in 1961 as a temporary program to manage trade has turned into permanent protection. As long as it is perceived to be permanent, there will continue to be an incentive for resources to be diverted into the sector. Is there any way the Multi-Fibre Arrangement (MFA) barriers could be reduced over time? The MFA is due to be renegotiated in the summer of 1986 and it would seem to be good timing to include this as part of a new round of multilateral negotiations. Could some portions of the textile and apparel industries be removed from the



MFA and subjected to greater market discipline? A long-term phase-out of the quotas could be part of the negotiating package if sufficient time for the phase-out is given.

The world economy may also be drifting into a regime of managed trade in steel. This raises a fundamental question of whether more progress would be made in dealing with the difficult adjustment problems of traditional industries like steel if new procedures or rules were established for discussing the issues in Geneva within the GATT. The history of the MFA does not necessarily provide a good model for multilateral discussions in exceptional sectors, but what is the alternative? It would be better for these problems to be discussed multilaterally than bilaterally, where the smaller trading nations and newcomers do not have any leverage.

### **Non-Tariff Barrier Codes**

More needs to be done to ensure fuller implementation and enforcement of the Tokyo Round codes, especially for subsidies and government procurement. To some degree these codes were oversold and now the perceived lack of international discipline in these areas is undermining the credibility of the system.

A thorough review of the codes operation might help to expose the deficiencies. Why have the review committees not been functioning as they were designed, to be an on-going forum for discussion and resolution of issues? Why have so few cases been filed under the codes?

These codes must be expanded to cover some of the "grey area" measures and enhanced to cover other non-tariff barriers. The subsidies code in particular needs to be revamped to put industrial and agricultural products on the same clear standard. What constitutes a "fair and equitable share of the market" is subject to varying interpretations and renders implementation and enforcement of the subsidy code for agricultural products almost impossible.

This raises a more general point about how the world has changed since the GATT was formed and the difficulty of writing substantive rules to cover these new practices. Ironically, success in reducing tariffs has led to widespread use of non-tariff barriers (NTBs) and subsidies which are less transparent than tariffs. What scope is there for negotiations on NTBs or for achieving greater discipline over subsidies? As it now stands, a great deal of analytical work would need to be done in order to determine the restrictiveness of existing NTBs and to develop the framework for negotiations, because NTBs are not as susceptible to reciprocal negotiations. Would it make sense to convert all NTBs to tariffs so that the restrictions allow market forces to operate and then seek to reduce the tariffs over time? This raises difficult compensation problems, but it would ensure transparency and allocation by market forces.<sup>7</sup>

There are empirical questions about the extent to which subsidies imposed for domestic purposes distort trade and injure foreign countries. It may prove impossible to write new substantive rules, but new procedural rules should be adopted in order to improve international discipline over subsidies.

## **Government Support in High Technology Industries**

Research-intensive high technology industries are among the most dynamic sectors within national economies and they exhibit above-average productivity growth. As a result, they are often accorded special status as part of national industrial development plans.

Is a concerted effort needed to address violations under the various codes and agreements in these sectors? What practices are acceptable for governments to take in supporting high technology industries? As the distinction between international and domestic economic policies has blurred, how do we judge what is acceptable internationally and what is not acceptable?

Because action in this area can easily infringe on national prerogatives and national sovereignty, it may be difficult for additional rules to be codified. A new complaints procedure and a forum for discussion would help to determine what is acceptable. A forum could also provide an outlet for discussion of other sensitive issues raised by attempts to regulate high technology sectors, including national security, technology transfer, extra-territoriality and export controls.

## **Services**

Service industries such as banking, finance, insurance, telecommunications, data processing, construction and transportation are becoming increasingly dominant in the world economy. Nonetheless, trade in services is being hampered by a wide variety of government measures that restrict or discriminate against imported services. The United States and Japan have proposed that the next GATT round should attempt to draft new rules to govern trade in these growing sectors. More recently the European Community has also expressed an interest in this.

The push for rules to govern trade in services is consistent with long-term restructuring within countries and in the world economy as a whole. In the United States, service industries account for over 65 percent of employment and have been responsible for the most rapid increases in employment over the past decade. This shift to the service sector is occurring in all of the major industrial economies. At a time when job generation is needed to absorb new labour force entrants and layoffs in the traditional goods sectors, emphasis on services is impor-



tant as a component of long-term structural adjustment policy. Proponents of services claim that this alone is sufficient reason to include this sector. This implies that the focus of the next round could be on long-term adjustment, both for the narrow reason of safeguards and adjustment in basic industries and for broad reasons in the shift from manufacturing to services. Finally, proponents argue that if services are not included, years would be lost because the round could not be completed before the early 1990s. In their view, the system cannot afford to ignore the issues which will be at the forefront for the rest of this century.

At the same time, many countries have reservations about the advisability of tackling these complex and, in many cases, still evolving and fluid sectors. The issues go beyond traditional commercial considerations and include questions of privacy and national security. The sectors are heterogeneous and the restrictions are not comparable. Trade ministers in many countries do not have the competence or authority to negotiate in service industries because other agencies regulate these sectors. How would negotiations proceed? To compound the problems, modern technology is rapidly transforming many of these sectors and it is difficult to separate the trade and investment aspects of services transactions. Would a statement of general principles and a standstill on new restrictions be a useful place to start? The Standards Code, which provided an umbrella agreement based upon fundamental principles, might provide a model for beginning to address such complexities.

The work program on services calls for individual countries to conduct national studies, but no multilateral review is specified. Is this issue ready for international discussions or are further instructions and more analysis needed? If services are to be negotiated in the GATT, one of the most important questions that will have to be resolved is whether to apply GATT Article I — most-favoured-nation treatment — to trade in services, or to introduce the notion of reciprocity in this area.

## **Trade-Distorting Investment Practices**

Local content rules and export performance requirements distort trade, and their use has been spreading in recent years. Unless steps are taken internationally to reach understandings on what is acceptable behaviour with respect to the use of these measures, trade conflicts arising from their use will multiply. As presently constituted, the GATT does not cover investment matters generally, but some existing agreements might be used to address trade-distorting investment practices. The GATT contracting parties need to decide if a special effort is required to address these practices or if they could be handled under existing agreements like the subsidy code.

## Counterfeiting and Intellectual Property Rights

The counterfeiting of trademarked commercial merchandise and the theft and duplication of intellectual property have become international problems which are spreading and increasing each year. In the United States alone, the International Trade Commission, an independent agency, has estimated that \$6 billion in trade entering the country is counterfeit.

In 1979, the United States and the European Community reached agreement (ad referendum) on the text of a code to deter international trade in counterfeited trademarked merchandise. Over the next two years, the United States and the European Community intensified efforts to broaden participation in the code. This effort resulted in multilateral discussions with a number of GATT countries, including Canada and Japan. The United States, the European Community, Canada and Japan reached agreement on a revised ad referendum text and agreed to have the text circulated by the GATT Secretariat. They also proposed that this text be used as the basis for negotiation of a code generally acceptable to all GATT members.

Although the draft agreement was accepted in principle by the four major countries, the counterfeit code was shelved at the GATT ministerial meeting and the council was instructed to examine the issue further. Some developing countries opposed any mention of the issue at the ministerial, arguing that it falls within the competence of the World Intellectual Property Organization (WIPO), not the GATT. The ministerial requested that the Director General hold consultations with the Director General of WIPO in order to clarify the issue and determine the appropriateness of joint action, but thus far little progress has been made. If no effort is made to address counterfeiting on an international level, individual countries will probably act unilaterally because political pressure is increasing for greater control over trade in counterfeit products.

## Trade-Finance Linkages

One of the most frequent but vexing questions being raised in international circles in the wake of the debt crisis is how trade, finance and development issues can be addressed in a more systematic fashion which takes account of the interrelationships among them. Adjustment programs of the International Monetary Fund often contain measures to restrict imports. World Bank loans and structural adjustment packages often go to expand capacity in sectors suffering from over-capacity or to underwrite projects which are viable only with continued government assistance. The GATT contains a balance-of-payments clause. Coordination between the GATT, IMF and World Bank must be improved to provide



greater consistency between short-term financial adjustment programs and longer-term structural adjustment in the world economy.

Internal coordination among trade and finance officials also needs to be improved. Last year there was a proposal for periodic meetings of the trade and finance ministers of the major industrial countries to discuss common issues and problems. Such discussions would help to educate and sensitize ministers to the interrelationships between trade and finance. Unfortunately, the initial attempt at getting them together was unsuccessful. Furthermore, no developing countries were involved. Although the industrial countries dominate in financial affairs, the developing countries have a strong interest and can influence trade policy. This complicates the problem of arranging for a dialogue among trade and financial ministers. Yet the need is real and therefore efforts to find the appropriate representational body should continue. If the representational questions can be worked out, the process itself should not be formalized but instead left informal, like the periodic meetings of finance ministers, because eye-to-eye contact and peer pressure are more important than agreement on a formal communiqué.

## **Institutional Change<sup>8</sup>**

The circumvention of GATT rules and processes over the past several years has contributed greatly to loss of confidence in the trading system. The next round needs to address the question of institutional changes to improve trade relations and make the GATT system more respected and responsive to emerging problems.

Ideally, GATT rules and processes should be used by a government to protect itself against itself. But in a world in which international discipline is lacking and exceptions are the rule, the GATT cannot be leaned on in order to resist taking restrictive actions. The difficult problems which are now sidestepped and handled outside of the GATT must be accommodated as much as possible within the system. Otherwise, the credibility of the system will continue to be undermined. Institutional changes are needed to ensure that trade issues and cooperation are continually addressed.

The dispute settlement process in the GATT is grossly inadequate and some cases have languished for years and years. Improved procedures are mandatory in a world in which technology can change the conditions of competition almost overnight. Dispute settlement procedures should be made more uniform and timely, and members should abide by decisions. The 1982 ministerial meeting did result in some tightening of dispute settlement procedures. A precedent was established that no single nation could veto the dispute settlement process. However, the real test will be in the application of this commitment. Unless disputes can be resolved in a reasonable, effective and equitable manner, the GATT

will continue to lose the respect of its members. One of the delays in reaching panel decisions is the difficulty of selecting panel members who are felt to be unbiased. A cadre of designated panel members, like administrative law judges in the United States, would help to facilitate dispute settlement decisions.

Failure to use the GATT on grounds that its dispute settlement is ineffective has a self-fulfilling effect. Therefore, whenever GATT principles are involved, parties should bring their complaints to the GATT with the understanding that without a prompt and equitable hearing the complaining parties will have no choice but to retaliate, perhaps outside the GATT framework.

One method for checking the spread of trade restrictions is to assure that they are visible and hold up under the scrutiny of public opinion. The international transparency of trade restrictions and violations should be improved. The GATT Secretariat should be given sufficient authority to publicize trade restrictions and violations of GATT commitments. New means are also needed to increase public awareness of the cost of trade restrictions (within member countries). It is often forgotten that the distributional consequences of trade restrictions are felt internally and not among nations. Unfortunately, most countries do not have the institutional framework to publicize the costs of trade restrictions. In the absence of national organizations which publicize the cost of restrictions, perhaps the GATT Secretariat should participate (i.e., testify) in quasi-judicial determinations of trade policy cases in individual countries.

Bilateral circumventions are spreading and undermining the multilateral system, but no one is representing the system. A system tender is needed to represent the general interest. The Secretariat should be ceded more authority to set agendas for Council meetings, publicize violations and take the initiative in responding to emerging problems. Countries with legitimate complaints of infractions of the GATT rules sometimes do not bring them, either because the other country is stronger or because they are bought off — perhaps at the expense of some third country. Although this may be rational for the country, the effect is damaging to the system.

Short of formal dispute settlement procedures, other procedural changes would help to improve trade relations. In many cases it will be impossible for the contracting parties to agree upon substantive rules, but procedural rules could help to minimize trade conflicts. Frequently, the best that can be achieved will be an agreement that certain kinds of situations must be kept under multilateral surveillance. A permanent surveillance committee would be helpful in monitoring compliance with GATT norms and perhaps in judging the legitimacy of trade policy actions in safeguards cases. Prior notification of new restrictions to the surveillance committee should be required and enforced.



A new mechanism for airing complaints is needed for those “grey areas” where restrictions are not now covered by GATT agreements or those cases where the rules are ambiguous or vague (e.g., what constitutes a “fair and equitable share of the market”?). Establishment of procedures for lodging complaints would help to determine which practices are acceptable and which are not.

A permanent negotiating committee should be instituted to respond to issues which are susceptible to negotiations between rounds. Perhaps more could be made of the review committees established under the non-tariff barrier codes. On-going negotiations would also help to strengthen the resolve of politicians, who could resist supporting a unilateral action on the grounds that multilateral negotiations were underway.

The creation of an on-going consultative process/arena (or, even stronger, an executive committee or trade policy board) would help countries to reach consensus more quickly on emerging problems. The consultative group of 18 has failed to perform this function, in part because it is cumbersome but also because of the level of representation in Geneva. If negotiations were in progress or if the GATT were to become more of an agency for on-going policy deliberations, the representational issue would presumably be resolved.

More frequent high-level ministerial meetings similar to the annual World Bank-IMF meetings would help to focus more attention on trade problems. This would provide an opportunity for political discussions among top-level trade officials at a mutually convenient time. It is unlikely that all politically sensitive bilateral issues could be handled in a large multilateral meeting, at least initially, but if all ministers were in the same city more often, the affected third-party interests could be addressed more quickly.

In sum, these institutional changes would ensure that trade issues would be dealt with on an on-going basis with procedures that could be appealed to as new issues arise. If such changes could be adopted in a new round, the system would become more capable of adapting to changing needs and the Secretariat could play a stronger role in representing the general interest. A stronger systems tender would be the best protection for the weak against the strong.

## Conclusion

This paper is hardly an answer to the question posed by the title. It amounts to little more than an elaboration of the questions I feel are raised by the title. However, one conclusion does emerge from this long list of issues which seem likely to frame the next round of multilateral negotiations. The next round will be different from those of the past because it will focus more on improving or extending the rules of the

game. Less time will be spent on reciprocal tariff cutting, which is easier for policy makers to follow and understand.

This raises one of the major issues surrounding the launching of a new round. How can it be made salable to legislators in many countries who have to grant the negotiating authority? If negotiators attempt to make a new round more salable by including sensitive issues like agriculture or new topics like high technology and services, they must be careful not to oversell the possible progress in these areas. The Tokyo Round codes are prime examples of initiatives which fell far short of the expectations that had been built up.

The content of the new round should be the subject of extensive discussions and debate, and it should be launched only after sufficient international consensus has been developed. If it is to be a broad multilateral negotiation, key developing countries will have to be included.

What items will have to be put on the agenda to entice these countries to negotiate? They have shown little interest in services, investment performance requirements, counterfeiting and high technology. They seem most interested in textile liberalization, greater market access, agriculture, safeguards and stronger rules.

With these issues included, development of a domestic consensus in the United States will be extremely difficult. Even the Reagan Administration, which loudly proclaims its support of free trade, has adopted more restrictive policies in textiles and steel. Greater market access raises adjustment problems in other labour-intensive industries. Stronger international rules covering international trade have been rejected by Congress ever since the failure to ratify the International Trade Organization in 1950.<sup>9</sup> Only in agriculture do the interests of the United States and the developing countries coincide, and then only because U.S. agriculture has something to gain as well as lose by establishing greater discipline.<sup>10</sup>

A further problem arises because of the priorities that Congress is likely to establish in granting negotiating authority. As it now stands, Congress is unlikely to grant the president the authority to negotiate unless services are on the agenda. Although services may be necessary to ensure a domestic consensus in the United States, what will it cost to achieve international consensus if they are included? At the 1982 ministerial meeting, the developing countries showed little interest in services. The cost could well be liberalization in the most politically sensitive labour-intensive industries. With renegotiation of the Multi-Fibre Arrangement currently scheduled for the summer of 1986, the cost could be in textiles and apparel. If that should occur, passage of the Trade Act of 1986 (1990?) could be more difficult than passage of the Trade Act of 1974, which took almost four years.



It is clear that a great deal of balancing will have to take place both domestically and internationally. The next 12 to 18 months will be critical as trade negotiators, internationally, and legislators, domestically, sit down to struggle with these issues.

Would a new round of trade negotiations help to improve trade relations? It would, because there is no alternative. In the absence of efforts to make progress on the important trade issues, the system will regress further toward more trade restrictions and impediments. The benefits of protection are concentrated and the costs are diffuse. Only when the protective structure is looked at as a whole, in the context of a major round of negotiations, do the diffuse gains for the nation become large enough for the political process to resist new restrictions. Furthermore, only in the context of a major round of negotiations do affected private interests — importers and exporters — mobilize and lobby effectively for liberalization. A new round will focus that attention and can improve trade relations, if individual nations can muster the political will.

Although the problems facing the trading system are grave, failure to deal with them is a prescription for disaster. Let us begin.

## Notes

This paper was prepared for the Research Symposium on Canada and the Future of the Multilateral Trading System held by the Royal Commission on the Economic Union and Development Prospects for Canada on July 24, 1984. The views expressed in this paper are solely those of the author.

1. See for example, M. Camps and C. Gwin, *Collective Management: The Reform of Global Economic Organizations* (New York: McGraw Hill, 1982) and the references cited therein including *GATT Plus — A Proposal for Trade Reform*, a report of the Atlantic Council (1976); and *Remaking the System of World Trade: A Proposal for Institutional Reform*, a report of the American Society of International Law, Studies in Transnational Legal Policy 12 (Washington, D.C., 1976).
2. This argument is more fully developed in C.M. Aho and T. Bayard, "The 1980s: The Twilight of the Open Trading System?" *The World Economy* 5 (4): 379–406.
3. "Developed and Developing Country Trade Issues" might be a better subtitle, but that would be almost all encompassing. All of the following issues are of importance in one way or another to both developed and developing countries. A North-South distinction is probably a non-starter, but it is used here as shorthand. It also needs to be acknowledged that the South is not a homogeneous grouping. Nor is the North for that matter.
4. See for example, W. Branson, "Trade and Structural Interdependence Between the U.S. and the NICs," paper presented to the National Bureau of Economic Research Conference in Kuala Lumpur, January 4–7, 1984.
5. For an analysis of the demographic and occupational characteristics of workers in trade-sensitive industries, see C.M. Aho and J. Orr, "Trade Sensitive Employment: Who Are the Affected Workers?" *Monthly Labor Review* (February 1981): 29–35. As an indication of the political power of two trade-sensitive industries, over 200 members of the U.S. Congress are affiliated with the textile caucus and almost 120 belong to the steel caucus. This helps to explain why these sectors are either excluded or given special treatment when new trade liberalizing initiatives like the Caribbean Basin Initiative or the legislation authorizing Israeli and Canada free trade areas are passed by Congress.

6. Even this may not be sufficient to allow negotiations to proceed. The U.S. Trade Adjustment Assistance Program was designed to ameliorate the adjustment burden of workers displaced by imports and was a key component of the legislative packages of 1962 and 1974, which granted the President the negotiating authority. The history of this program does not make one sanguine about its future role in allowing trade liberalization in labour-intensive industries in which the developing countries are most competitive. See C.M. Aho and T. Bayard, "Costs and Benefits of Trade Adjustment Assistance," in *The Structure and Evolution of Recent U.S. Trade Policy*, edited by R. Baldwin and A. Kreuger, pp. 153–91, NBER Conference Volume (Chicago: University of Chicago Press, 1984).
7. See G. Hufbauer and H. Rosen, "Managing Comparative Disadvantage," (Washington, D.C.: Institute for International Economics, December 1983, unpublished paper).
8. For an excellent elaboration of many of the points raised here, see W. Diebold and M. Camps, *The New Multilateralism: Can the World Trading System be Saved?* (New York: Council on Foreign Relations, 1983). Since completion of this paper but before it went to press, a GATT consultation group issued a report entitled *Trade Policies for a Better Future: Proposals for Action* (Geneva: GATT, March 1985). The report recommends many of the changes mentioned in this section.
9. In addition to the International Trade Organization, Congress also failed to act on the Organization for Trade Cooperation in 1956 and the Antidumping Code in 1967.
10. As the reference to agriculture calls to mind, all of this discussion ignores the difficulty of getting the European Community to agree on the content and timing of a new round. Japan has been actively promoting a new round.





## **Which Way: Canadian Trade Policy in a Changing World Economy**

JOHN M. CURTIS

Four recent developments have heightened interest in Canada's trade policy: dramatic changes in the world economy; the responses of other countries to these changes; the erosion of the international trading system; and a perception that Canadian economic performance over the past decade has been less than satisfactory. Because of the importance of foreign trade and international investment to the Canadian economy, events taking place in economies outside Canada's borders and in the international trade system itself have always had a direct and often a profound impact on the performance and structure of the Canadian economy. Moreover, changes within Canada in recent years have added to the complexity of defining and carrying out an effective trade policy in a world economic environment that is more competitive and less predictable than it was in the earlier decades of the postwar era.

### **The Elements of Trade Policy**

Traditionally, trade policy has been thought of in terms of the rules and practices that governments apply both singly and collectively, and the instruments that they use, in managing the exchange of goods and services across national boundaries. These include broad horizontal policies such as tariffs, quotas, anti-dumping and countervailing duties, product standards, customs valuation and administration — that is, those policies involving generalized rule making, as opposed to vertical or sector-specific policies. Analysis and attention over the years has been concentrated on the use of these trade policy instruments in terms of their impact on the volume, direction, composition and terms of trade,

as well as on individual, national and international consumer welfare.<sup>1</sup>

Trade policy has also been thought of as part of the overall foreign policy of the nation-state. Its status in this larger perspective has changed over the years. In the early period after World War II, most foreign policy analysts relegated it to the category of "low politics."<sup>2</sup> Issues of national defence and strategy, and of the political relationships among states, were considered more important and thus more central to the study and conduct of foreign policy. Over the past twenty years, however, economic concerns, including international economic policy issues, have attained a higher priority on the public policy agenda of all countries. Foreign policy has come to be defined increasingly in economic terms (Cooper, 1972).

Trade policy has not only become a larger feature of international relations in general, but also has come to include what traditionally were thought of as domestic policy issues and instruments.<sup>3</sup> This internalization of domestic policy concerns has arisen largely because of two major changes in the postwar period: the increased economic interdependence of the world's economies and the increased role of government in the management of each country's domestic economy. Increased interdependence means that the economic performance and policy actions undertaken in one country have a greater impact on others. The fact that governments are larger actors in these economies means that economic actions, whether domestic or international, are necessarily subject to more political scrutiny and reaction on the part of those countries most affected.

No longer, then, are policies relating to the cost and availability of money, public spending, investment, industrial and regional development, agriculture, transportation, taxation, procurement, consumer and environmental protection, competition, technology, or manpower exclusively domestic in today's increasingly integrated world. What one country does with respect to these policies as a matter of an explicit, concerted plan or in a more ad hoc manner is of interest to its trading partners. Trade policy, therefore, now has an increasingly vertical or structural focus compared to the broad, generalized rule-making focus of earlier years. Some even refer to trade policy today as being in essence a strategy for global industrial organization.<sup>4</sup>

## **The Changing World Economy**

Much has been written in recent years about the changes in the world economy and its component parts. While many views have been expressed about the nature and relative importance of these changes, there appears to be a general consensus that the world economy is being transformed at a rate perhaps unprecedented since the period of the "second" industrial revolution late in the nineteenth century. This rapid



transformation is making the world at best more uncertain and at worst more dangerous. It certainly has become more volatile, less predictable, and more competitive in an economic sense.

The following changes appear to have had the most impact on the world economy, on its institutions, and specifically on Canada.

**Acceleration in the rate of technological change** While the causes and magnitude of this phenomenon are as yet unclear and are much debated, its existence is no longer much in doubt. Because rates of development, diffusion and adoption of innovations vary among countries, regions and sectors, the gains and losses from the rapid technological change of recent decades have been felt unevenly.<sup>5</sup>

**A worldwide slowdown in the rate of growth of GNP and an even greater decline in the rate of growth of international trade in the late 1970s and early 1980s** The causes of the overall slowdown in growth in a period of rapid technological change are much debated. They include a rapid increase in the price of energy and the effect of this increase on other prices, growth of the service sector, and the policy focus in many countries on the distribution of wealth rather than on economic growth.<sup>6</sup> The slowdown in the rate of international trade over this period has had a particularly negative impact on countries that are highly dependent on trade (Blackhurst, Marian, and Tumlin, 1977).

**A shift in the composition of world trade from resources (excluding oil) to certain manufacturing sectors and to services<sup>7</sup>** For reasons by now fairly well understood, the interplay between income, price, technology, and consumer tastes over time leads to a decline in the quantity of natural resources required per unit of production. Much trade now is conducted between countries with broadly similar economic structures. In the classical economic literature, differences in endowments of natural resources were established as the major factor determining trade patterns. Today there is increasing scope for countries to create competitive advantage through deliberate economic development and trade strategies, a frequent and increasingly important phenomenon.<sup>8</sup>

**Shifts in the worldwide pattern of industrial investment and production** The growing internationalization of production activity, sometimes involving world product mandating and at other times arms-length component sourcing in certain countries and assembly in others, has been dramatic over the past twenty years (Balassa, 1979; OECD, 1981a). This development has been associated with the rise of the multinational enterprise but is not uniquely due to this form of industrial organization.<sup>9</sup> Indeed, in many countries including Canada, the multinational form of organization, which originally consisted of complete production

facilities located in more than one country, predates this more recent internationalization of production activity by decades.

**Increasing competition in the developed countries from suppliers in the newly industrializing economies and in certain other developing countries**

In response, the developed countries have had to adjust or to shift resources to higher value-added production involving labour, management and capital resources. They have also attempted to cope with this increased competitiveness by political commitments and actions to stop or to slow down the changes, these actions often taking the form of trade restrictive measures.

**The shift from economic pre-eminence of the United States in the early postwar period to shared dominance by the United States, Western Europe and Japan (Kindleberger, 1981)**

The United States emerged from World War II with a disproportionate share of world production (some estimates suggest that about 42 percent of the world's economic activity in 1945 took place in that country) and as banker for the world. American economic performance and policy ideas had a dominant influence on the postwar world economy and on its institutions.<sup>10</sup> Its hegemonic position eroded during the 1960s and the 1970s, first under the challenge of Western Europe and later that of Japan. While the United States remains by far the single most important economic power, the economic activity and policy behaviour emanating from the two other economic centres are now relatively more important than they were. To a significant but far lesser extent, economic activity, policy initiatives and responses of the Third World have also become increasingly important in the international policy environment, as have those of the socialist community, particularly in an intra-European context.

**Increased management of international trade on the part of both governments and transnational corporations**

The changes outlined above, aggravated by the recession of 1981–83, have led many countries to use trade measures to protect domestic producers against international competition and to try to influence the investment location decisions of multinational enterprises.<sup>11</sup> The number of sector-specific trade arrangements has steadily increased, beginning with cotton textiles in the early 1960s and now including synthetic textiles, clothing, footwear, automobiles and steel, to name just a few. Pressures to conclude more such arrangements are evident globally, and labour groups often join with industry in urging government action.<sup>12</sup> In the agricultural sector, protectionism has never abated. Supply management and import control mechanisms have been in place in the developed countries for many years, some dating from the 1930s.<sup>13</sup>



While protectionist forces have been held fairly well in check<sup>14</sup> — in spite of difficult economic circumstances and the consequent political pressures — the threat of further protectionist actions remains very serious. This is particularly true in the United States, where the present trade policy agenda is strongly influenced by a very high merchandise trade deficit, an overvalued exchange rate, and a perception that its main trading partners are engaged in at least some “unfair” trade practices.

**Increased integration of world capital markets** The flow of both portfolio and equity investment has greatly expanded over the past 25 years, affecting the monetary and exchange rate policies of individual countries as well as national and international financial institutions.<sup>15</sup> The impact on international trade, the nature and size of which continues to be debated,<sup>16</sup> is transmitted through changes in exchange rates caused at least in part by changes in countries’ capital accounts.

**Volatility in and misalignment of exchange rates** Since the ending of the fixed exchange rate element of the Bretton Woods system in 1973, the predictability of exchange rates has declined considerably. Criticism of the more rigid system of the 1950s and 1960s has been replaced by equally harsh criticism of the current floating system.<sup>17</sup> A general consensus on an ideal exchange rate management system has not yet emerged, but many governments and private sector bankers favour leaving the system much as it is now.<sup>18</sup>

**Growth in the major external debt problems of many developing countries in Latin America, Asia and Africa** The growth of indebtedness, especially with respect to the private commercial banks, evolved into a crisis by mid-1982 but has generally been managed quite effectively since then. Besides having an impact on the international financial system, the debt situation has led developing countries to deflate, intensify their import restrictions and devalue their currencies, and has put pressure on OECD countries to lower their barriers to exports from developing countries. The 1981–83 recession increased both the need for and resistance to policy changes on the part of all countries to relieve the debt problems of the developing countries.

**Decline in the effectiveness of the GATT** The adherence of member countries both to specific GATT rules and to the general principles of the system has been in decline.<sup>19</sup> All the factors mentioned above have contributed to this trend. In addition, there is some evidence of erosion of the political will to make the GATT system work, due to changed perceptions of national and regional self-interest in a changing and uncertain world economy and, more seriously, perhaps also to a declining belief in the value of international cooperation.

Nevertheless, the current situation should not be over-dramatized. The international trade system, though weakened, has not collapsed. While GATT rules and norms of behaviour have been sidestepped or disregarded in a number of areas, they continue to govern much of the world's trade and remain the standard against which trade actions are measured. And there are many proposals for reforming and re-energizing the international trade system, ranging from initiating a new GATT round later in this decade to pursuing trade liberalization and the strengthening of the rules governing international trade through bilateral, regional, sectoral, or functional arrangements.<sup>20</sup>

Overall, it appears that no country, large or small, is prepared to risk the collapse of existing international systems for economic cooperation. The two largest market economies, the United States and Japan, have continued to give overall support to an open international trade system, and the international banking system, involving both private and public institutions, has so far been able and willing to restructure the debts of the major developing countries to avoid serious disruption of the international economy.

## **Canadian Trade Policy**

Canadian trade policy has been defined and conducted over the years in the context of a relatively small national economy functioning as part of a wider global system. Like other sovereign states faced with unequal trading partners and confronted with the reality of the link between domestic economic policy, the financial and trade system, and trade performance, Canada has sought consistently over the years to ensure improved and secure access to foreign markets while using tariffs and other measures to protect Canadian sectors subject to particular pressures. In pursuing these objectives, Canada has generally supported the maintenance of international rules and procedures which, among other things, have offered some protection against the introduction of arbitrary unilateral trade measures by larger trading partners that could seriously damage Canadian interests.

The earliest trade policy of Canada (or what became Canada) was essentially mercantilist. Canada was the subject of favourable tariff and purchasing preferences first by France as the imperial power and after 1763 by Great Britain. Upon the adoption of free international trade by Great Britain in 1846 with the repeal of the Corn Laws, preferences for Canadian exports in the British market were phased out. This change in British trade policy involved serious economic consequences for the British North American colonies which increasingly led them to turn southward to the United States. Initially, this evolving continentalism led to a highly selective free trade agreement between the colonies and the United States from 1854 to 1866.<sup>21</sup> This early bilateral reciprocity



arrangement was not renewed, however, because of tensions between Britain and the United States during the American Civil War and the adoption of highly protectionist U.S. import policies after the war. The British North American colonies were forced to look more to each other for trade prospects, one of the major impetuses leading to Confederation.<sup>22</sup>

In the immediate post-Confederation period, abrogation of the reciprocity agreement and imposition of high U.S. tariffs on many Canadian exports forced Canadians to search for new trade and other economic development policies. Sir John A. Macdonald's National Policy was the framework finally decided upon late in 1878. It provided for tariff-supported industrial development in central Canada and the encouragement of agricultural and resource development throughout the country by a state-supported transportation network, immigration, and cheap land in the West.<sup>23</sup>

While very high tariffs and other protectionist devices remained in place from the time the National Policy was introduced until just before World War II, several policy initiatives to liberalize Canadian trade policy and practices were undertaken during this period. These attempts at liberalization were generally frustrated and in 1911 led to the defeat of the government when a bilateral freer trade arrangement with the United States had been worked out. However, Canada did unilaterally implement preferential tariff rates in favour of the United Kingdom and the rest of the Empire as early as 1902. These imperial preferences gradually evolved into the Commonwealth Preference System as Canadian measures were reciprocated by other countries within the British Empire, including Great Britain itself, after the Ottawa Economic Conference of 1932. Shortly thereafter, faced with continuing economic deterioration and in response to initiatives of the new Roosevelt Administration, Canada entered into non-discriminatory bilateral trade arrangements with the United States. The Canada–United States trade agreements of 1935 and 1938 halted the escalating protectionism between the two countries and began the process of trade liberalization that was generalized and accentuated after World War II under what became the GATT system.

During and immediately after the war, Canada participated actively in the discussions of international trade policy that led to the establishment of the multilateral international economic institutions, including the GATT (Stone, 1984, chap. 3). At least three factors might be said to have influenced Canadian policy at this time.

- The United States wished to bring about the multilateral adoption of the principles of non-discrimination, reciprocity, and liberalization which were embodied in its Reciprocal Trade Agreements Act of 1934. As the principal economic partner of the United States in a highly

asymmetric relationship, Canada had little choice but to follow the American lead.

- Prevailing economic thinking, based originally on the doctrines of Adam Smith and David Ricardo and given more contemporary expression by Eli Heckscher, Bertil Ohlin and Gottfried Haberler, was that an open trade system with minimum intervention in markets would maximize the benefits of allocative efficiency and increase welfare for all.
- As a smaller economic and political power, Canada felt that a body of accepted international trade law would constrain the capacity of its larger economic partners to implement unilaterally trade policies and measures that would damage Canada's trade and other economic interests. Indeed, Canada regarded the establishment of the GATT as an effective means of gaining more assured access to the large U.S. market (Stone, 1984, chap. 3).

Overall support for the multilateral trade and payments system has remained the fundamental approach to, and cornerstone of, Canadian trade policy ever since. The federal government has reaffirmed this position over the years. In the 1983 report on *Canadian Trade Policy for the 1980s* (Canada, Department of External Affairs, 1983a), the government emphasized that it would: (a) give first priority to efforts to strengthen the multilateral trade and payments system by broadening both its scope and its powers; (b) seek to ensure that foreign laws, regulations and practices do not adversely affect access to export markets of Canadian producers; (c) fully exercise Canada's rights under bilateral and multilateral trade agreements so as to safeguard access to export markets; (d) work more closely with Canadian producers and provincial governments to seek out and develop new export markets and derive maximum potential from existing markets, and (e) adopt and implement new legislation intended to ensure that Canadian producers benefit fully from Canada's rights under international agreements to deal with unfair and injurious imports, using procedures that are as responsive, efficient and effective as those of its major trading partners.<sup>24</sup>

The government thus confirmed its position that the multilateral approach is the best way for Canada to achieve its two basic trade policy objectives — the development of a stronger, more competitive, non-inflationary domestic economy; and the promotion of a more stable and open international trading environment within which both Canadian and foreign firms are encouraged to plan, invest and grow. The 1983 report argued that while other rights and obligations, including those existing under bilateral arrangements, should be maintained and perhaps even extended, a radical shift in Canada's trade policy framework was neither warranted nor practical, notwithstanding changes in the world economy and in the policies and practices of Canada's major trading partners.



## Perspectives for the Future

Nevertheless, the changing world economic environment and Canada's role within it have raised questions about both the adequacy of existing trading arrangements and the feasibility and likelihood of further international trade liberalization on a multilateral basis in the near term. For example, the federal government's tentative suggestion, in its 1983 review of trade policy, of possible further bilateral arrangements with the United States reflected a wider public concern about existing Canadian economic policies, especially about the economic relationship with its largest trading partner. In addition to the various elements of change in the world economy referred to in the section above, several new factors seem to have given impetus to this concern.

- The continued and generally increasing reliance of important sectors of the Canadian economy on markets in the United States has been accompanied by a succession of threats of restrictive import measures and some actions by the United States since 1982 which had affected these sectors adversely. The export risk faced by firms locating in Canada becomes much greater when trade practices governing access to the U.S. market become increasingly administered or discretionary. Since the need to export in order to reach world efficient scale and productivity has always been higher for firms investing and producing in small economies, uncertain access to export markets, even with fully efficient production, marketing, and distribution facilities, has become a serious issue for Canada (Hay, 1982, p. 18).
- The current strong Canadian merchandise trade balance is dependent on basic resource industries, automobile exports, and a recession-induced weak volume of imports.<sup>25</sup> The latter two factors could change quickly, and resource exports are coming under intense competitive pressure from other foreign sources. Some have argued that increased competitiveness and growth in other parts of the world have already caused Canada's absolute share of world exports to decline since 1970.<sup>26</sup>
- The over-valuation of the Canadian dollar in terms of the currencies of most countries except the United States has undermined traditional Canadian exports of agricultural, fish, and forestry products to third markets and frustrated attempts to achieve a greater diversification of Canadian exports in these same markets.
- Subsidies in forms such as incentives in support of research and development and tax credits are becoming an increasingly important aspect of industrial development in those industries heavily involved in international trade — urban mass transit equipment, capital goods, etc. The ability of smaller trading countries such as Canada to finance the vast amounts needed is limited (Hay, 1982, p. 18).

- The existence of extensive multinational corporate links means that a major share of Canada's international trade in manufactured goods is conducted at non-arm's length. Whether or not such trade is as responsive to a broad array of government policy as is an arms-length trading environment is an open question.<sup>27</sup> The prevailing wisdom appears to be that intracorporate links probably constrain the policy choices open to national governments, including the Canadian government.<sup>28</sup>
- Canada is the most decentralized of all the major trading nations in terms of decision making. While the diffusion of authority and responsibility need not be detrimental, it does increase the need for harmonization of federal and provincial policies in response to other countries' trade policies and practices and in terms of the reciprocal demands that these countries might place on Canada as part of international agreements.

These features of Canada's present economic performance and development, in the context of a rapidly changing international environment, suggest that changes in emphasis in Canadian trade policy will depend largely on external circumstances. There is little reason to think that the two central objectives of Canadian trade policy — the development of a stronger, more efficient, non-inflationary economy and the promotion of a more stable and open international trading environment — will or should change, but the policies and strategies to achieve them could vary. At least four possible international trade approaches are open to any sovereign country in a world economy organized as it now is on the basis of international cooperation and laws.<sup>29</sup> These four approaches, developed below with no particular bias in terms of feasibility or effectiveness, are unilateral action, bilateral arrangements, regional or plurilateral initiatives, and multilateral rules and norms of behaviour.

### *Unilateral Action*

A country may choose unilaterally to increase or decrease tariffs or to adopt other measures to affect its imports and exports. Unilateral trade policy measures are usually aimed at increasing a nation's barriers to imports, generally in order to shelter domestic industry from international competition. Subsidies to export industries are also becoming important, but these are often designed to meet industrial or regional objectives rather than trade policy objectives.

Such unilateral measures might violate previous obligations under multilateral, regional, or bilateral trade agreement rules. If so, the country might face demands for compensation from its trading partners whose interests are damaged, and might risk retaliation in the form of restrictive measures. These risks are naturally greater for small coun-



tries than for larger, more powerful countries. Restrictive import measures unilaterally introduced by Canada, even when compatible with GATT rules, have sometimes run into unfavourable reactions from trading partners, especially the United States, and have been accompanied by demands for compensation and retaliatory threats or actual retaliation.<sup>30</sup>

With respect to unilateral trade liberalization, most of the economic literature has demonstrated conclusively that a country can improve its welfare by unilaterally reducing its tariff and non-tariff barriers.<sup>31</sup> The theory supporting this case is straightforward. A country that unilaterally cuts its tariffs and other barriers to imports lowers the cost of imports, including imported inputs. This reduced cost in turn will lower its cost of production and improve efficiency, which in turn may increase the country's potential for international trade and improve its economic performance.

However, the lessons of the past, knowledge of negotiating strategies, and the need for more open and assured access to foreign markets suggest that unilateral measures are not an optimal or effective basis for Canadian trade policy. For this reason, unilateral actions by Canada to lower barriers have been rare.<sup>32</sup> Canada has sometimes reduced tariffs without asking for corresponding reductions by its trading partners, for anti-inflationary reasons and as part of the General System of Preferences to help designated developing countries.<sup>33</sup>

### *Bilateral Arrangements*

Bilateralism, involving some kind of formal arrangement between two countries, has characterized aspects of the trading relationships between many countries during much of this century. In the postwar era, it has been most prominent in trade involving the non-market economies, although bilateral practices because of foreign exchange considerations were quite common in the Western economies immediately after World War II. More recently, bilateralism in the form of counter-trade arrangements involving developing countries has become increasingly common, again often because of foreign exchange difficulties. A bilateral approach to trade policy has also been evident in recent years with respect to trade-restrictive measures involving certain sectors such as steel, automobiles and textiles.

Trade liberalization has also been pursued bilaterally over the years by Canada and by other countries. Bilateral agreements between Canada and the United States include arrangements regarding agricultural machinery in the 1920s, the Defence Development and Defence/Production Sharing Arrangements in the 1940s, and the 1965 Canada–U.S. Automotive Agreement. Canada has complemented its other trading

arrangements with bilateral agreements in these areas to improve its productive efficiency and export capability.<sup>34</sup>

In 1983, Canada proposed a further bilateral initiative to liberalize trade. While explicitly indicating continuing interest in a multilateral approach, the Canadian government proposed holding exploratory talks with the United States on bilateral sectoral arrangements.<sup>35</sup> The reasons for this particular initiative were not specified but many could be inferred.

- U.S. tariffs and other barriers could be lowered more quickly by a bilateral initiative than they could be under the GATT.
- Canada might obtain specific exemption from the operation of U.S. legislation governing anti-dumping and countervailing duties, escape clause measures, government procurement rules, etc.
- Canada might also be exempted from other U.S. protectionist measures such as quotas on beef and sugar imports, providing a basis for exemptions from such special restrictive measures in the future.
- Special bilateral rules might also be negotiated that would go beyond existing or probable GATT norms to deal with issues of special and perhaps unique concern to the two countries, such as the use of safeguard measures, domestic and export subsidies, and international trade in certain service sectors.

The reasons underlying the specific suggestion of a sectoral, rather than a more comprehensive bilateral approach with respect to the United States might also have included these considerations.

- Most of the adjustment to freer trade would be intra-sectoral rather than inter-sectoral (Wilkinson, 1984).
- A subsequent unilateral amendment or abrogation of any sectoral free trade arrangement by the United States would have less impact on the Canadian economy than it would have under a more comprehensive arrangement.
- A sectoral initiative would have fewer negative implications for Canada's political sovereignty.

Nevertheless, a number of concerns have been raised regarding wisdom of a bilateral approach to Canada-U.S. trade liberalization, both in its more general form and in its specific sectoral context.

- The possibility of achieving more secure access to the U.S. market, especially with respect to non-tariff barriers, would be greater if all countries join in exerting pressure on the United States through the GATT process.
- Violating the existing GATT rules by pursuing bilateral arrangements might raise the question of GATT waivers, demands for possible compensation, and acts of retaliation on the part of third countries, with costly consequences both for Canada and the United States.



- The future of the international trade system could be gravely threatened by a bilateral arrangement between the United States and its largest trading partner.
- A bilateral arrangement with preferential treatment of each other's exports would involve significant trade diversion and impose costs in terms of allocative efficiency and welfare.
- The price that the United States might demand for agreeing to a bilateral arrangement might involve an unacceptable degree of interference in the Canadian economy or in other aspects of Canadian life, such as (a) regulatory convergence or harmonization of Canadian energy, transportation, communications, and investment policy with U.S. policy; (b) guaranteed access to Canadian resources of gas, oil, hydroelectric power, and fresh water; (c) an end to Canadian content rules with respect to the media; and (d) the congruence of Canadian and U.S. exchange rate and tax policies, and perhaps also of defence expenditures.
- A formal bilateral treaty would need U.S. Congressional approval involving the consent of two-thirds of the Senate. The Administration could not assure passage of such a treaty, nor could it ensure that Congress would not raise the price prohibitively for concessions to Canada.<sup>36</sup>
- Future differences over interpretation of a bilateral agreement or conflicts arising from departures from its requirements would involve negotiations in which Canada would inevitably be the weaker partner.
- With respect to the bilateral sectoral approach in particular, there would be difficulties in reaching quid pro quos and making trade-offs between sectors. Also, special interest groups might strongly resist any change in particular sectors under negotiation. Therefore, a bilateral barrier-by-barrier (functional) approach, although enormously difficult to negotiate, might be better than a sector-by-sector approach.

In spite of these concerns, bilateral arrangements, perhaps on a sectoral basis, might become even more common throughout the world economy during the 1980s and 1990s because of the uncertainties of foreign exchange markets and other reasons cited earlier in this paper. Canada might therefore have to make adjustments in this direction as part of its overall trade policy. The conditions under which this possible change toward a more bilateral approach might be more or less desirable is set out in the concluding section of this paper.

### *Regional or Plurilateral Initiatives*

Canada and Australia are the only major industrialized countries that are not part of an institutionalized trading arrangement involving 100 million or more people. Entry into a trading bloc of several nations has always

been a tantalizing prospect for some Canadians who are reluctant to contemplate institutional arrangements with the United States alone. The Commonwealth Preference System presented some opportunities of this type although it never developed into a free trade area.<sup>37</sup> While Canada's prewar and early postwar trade patterns were influenced to some extent by these preferences, they are now very much less important. Commonwealth preferences in the British market have been replaced by European Community tariffs around the British market and by Lomé Convention preferences involving many Commonwealth developing countries. Concepts of a formal North Atlantic trade group, popular in the 1950s and 1960s, have also long since vanished. In effect, Canada has replaced its British preferences with non-reciprocal tariff preferences open to almost all developing countries.

There are, however, some regional trade policy approaches that might still be relevant. One is a Canada-U.S.-Mexico free trade area, which has been informally talked about for years and received some official attention in the United States several years ago. In particular, Section 1104 of the U.S. Trade Agreements Act of 1979 asked that the Administration study possible new trade arrangements in the northern portion of the Western Hemisphere, a task which was completed in 1982 but which generated little public attention. Ronald Reagan, as a candidate and in his first year as President, talked of a special trading bloc arrangement (a "North American accord") involving Canada, the United States, and Mexico. Canadian and Mexican leaders responded unenthusiastically, because while both countries have much to gain from an arrangement with the United States, they have little to offer each other (Hay, 1982, p. 20).

An even more elusive, but currently much talked-about, regional trading approach is the idea of a trade arrangement among the Pacific Rim countries.<sup>38</sup> One version, discussed since 1968, suggests that a grouping of the five advanced Pacific countries (Australia, New Zealand, Japan, Canada, and the United States), the six members of the Association of Southeast Asian Nations (the Philippines, Indonesia, Malaysia, Singapore, Thailand and Brunei) and probably several newly industrializing economies such as Mexico, Hong Kong and South Korea.<sup>39</sup> At the moment, interest in this concept is found largely in Japan, Australia and South Korea. In Canada certain business groups, the federal government (through the Asia Pacific Foundation of Canada<sup>41</sup> and other initiatives) and several provincial governments are taking a steadily greater interest as the Pacific Rim region includes Canada's fastest growing international trade markets.<sup>40</sup>

A more recent idea is to form a group of like-minded countries — not necessarily geographically contiguous — to pursue trade liberalization more quickly than the multilateral process allows. Unlike the earlier Commonwealth Preference System, this concept would be an open-



ended arrangement. The proposed trade liberalizing arrangements would be open to any country willing to accept the obligations and responsibilities of the particular trade arrangement.<sup>42</sup> The emphasis would be on sector-by-sector or perhaps barrier-by-barrier (functional) reductions at a pace faster than could be achieved by the full membership of the GATT.<sup>43</sup> While the barriers and/or sectors to be addressed in this way have never been definitively set out, safeguards, regulations involving certain service sectors, and agreements on what constitutes acceptable subsidies have been mentioned.

### *Multilateral Rules and Norms Behaviour*

Multilateralism has formed the basis of Canadian trade policy since World War II. Canada has adhered to multilateral principles while pursuing complementary bilateral initiatives in areas where it has relatively more strength and hence a better bargaining position. This approach has rested primarily on the belief that a multilateral forum permits greater gains than any other for all countries, and especially for a relatively small economic power. It is argued that in the multilateral approach Canadian interest is likely to be consonant with one or other of the major economic powers on any particular trade issue.<sup>44</sup>

This view was borne out at least partially by the last major round of multilateral negotiations, the Tokyo Round (1973–79). Canada gained much by the negotiations. Tariffs of the industrialized countries will be cut by an average of 40 percent by 1987; by then, some four-fifths of Canadian exports into the United States, for example, will be duty free. In addition, the GATT rules governing a range of non-tariff measures, such as anti-dumping and countervailing duties, technical standards, government procurement, and customs valuation were strengthened or extended. Most of these new rules have had a favourable impact on Canada.

Much unfinished business remains, however: the improvement of dispute settlement procedures; the tightening, transparency and specificity of the codes such as those involving safeguards; and other questions such as agricultural trade policy, remaining tariffs in other sectors, and the issues of structural adjustment, resource price stabilization, and selectivity, to name but a few. The November 1982 GATT ministerial meeting and the most recent meeting of the GATT Contracting Parties in Geneva indicate that it will be a difficult and slow process to achieve agreement on many of the so-called old or new trade policy issues during this decade, whether or not a new GATT round takes place.<sup>45</sup> While the United States continues to be the driving force in shaping the nature and pace of the international trade policy agenda, its capacity to influence the multilateral process and its commitment to multilateralism are less than they were, for the reasons discussed earlier. The commitment of the

European Community and the broad, heterogenous group of developing countries is even less certain. It seems likely, therefore, that negotiations toward further trade liberalization on a multilateral basis will be prolonged. It also seems likely that protectionist pressures and actions in specific sectors by individual countries or groups of countries, including the United States, will continue throughout the 1980s.

The emerging international trade environment might well be such that multilateralism will not be as effective an approach to trade policy for Canada as it has been in the past, particularly in view of Canada's relatively weak economic performance at home in recent years. Most important, reliance on multilateralism may leave Canada poorly equipped to deal with the growing economic nationalism and protectionism in the United States — be it secular, cyclical, or exchange rate-related. This is probably the most critical of all the changes in the world economy from Canada's standpoint.

### **Toward a "Strategic" Canadian Trade Policy**

The appropriate next step with respect to trade policy involves very difficult choices for Canada. Given the importance of international economic transactions to the Canadian economy, the choices made over the next few years will significantly influence the economic performance of the country as a whole and of its regions — in terms of income growth, investment, employment, productivity and competitiveness of various economic sectors — well into the next century. The choices made will also affect the structure and operation of many Canadian institutions, including federal, federal-provincial, and public sector-private sector arrangements with respect to trade, as well as quasi-judicial organizations such as the Canadian Import Tribunal. It might well lead also to the creation of new bilateral and multilateral institutions. Perhaps less directly, the choices made will affect Canada's political processes, ranging from the degree of national autonomy over economic policy decisions to the quality and form of the relationship between labour, business and government in trade policy matters. The increasingly important relationship between the transnational corporation and the government at the sectoral level could also be affected.

In terms of the development of a strategic trade policy, the following points seem clear.

- The two fundamental objectives of Canadian trade policy, namely the development of a more competitive Canadian economy and the promotion of an open and more stable international trading environment, continue to provide a sound basis for economic development in terms of generating the investment and employment opportunities necessary to ensure a rising level of national income.



- The basic overall approach to achieving these trade policy objectives by pursuing trade liberalization remains sound. The question of the pace of such liberalization and of the necessary accompanying institutional arrangements remains central.
- Changes currently going on in the world economy, in the operation of the international trade system, and in the directions of U.S. trade policy have introduced new elements of instability and uncertainty in the world economic environment, with direct implications for Canada.
- The Canadian economy continues to perform relatively poorly in terms of investment spending and of capital and labour utilization. Its medium-to long-term prospects, given present policies, will not lead to the full realization of the economy's growth potential.
- The multilateral trade system, while in considerable disarray, has not broken down. If the larger trading powers continue to support it, there is still scope for improved discipline and regulation of those non-tariff measures, such as countervail, anti-dumping, and government purchasing practices, which have the greatest impact on international trade, production, and investment decisions.
- Although they comprise only about one-quarter of the markets for Canadian exports and imports, Japan, Europe and the developing world are important markets for Canada, particularly for certain regions and sectors, and should remain part of the broader Canadian trade policy perspective.
- Canada's trading relationships with the United States will remain central to long-term Canadian economic performance. Canada should vigorously pursue every feasible step to reduce risks in the bilateral relationship and achieve improved, assured and freer access to the large U.S. market. In this context, initiatives between the two countries could deal bilaterally with old issues such as safeguards and code enforcement, as well as with newer ones involving such questions as trade in services and trade-related investment, as part of the preparations for a further multilateral round. An agreement between the two countries could thus serve as a model for new multilateral arrangements. If progress in advancing the reform of the multilateral system turns out to be slower than hoped for or impossible, bilateral arrangements with respect to some or all of the issues above, including a comprehensive free trade area, could be opened to all countries willing to accept the obligations involved. Whether the multilateral talks go forward quickly or slowly, bilateral agreements to reduce or eliminate barriers to crossborder trade, reduce the impact on Canada of protectionist measures aimed primarily at other countries, and eliminate "buy American"-type legislation with respect to Canada would contribute importantly to long-term investment, production, and income growth in Canada.

- Since international trade policy increasingly involves issues of global industrial organization and investment, Canada's political structure requires that provincial governments and relevant private sector interests should become increasingly involved on a continuing basis in trade policy development. This more concerted consultative approach would involve issues such as investment, production, labour adjustment, and export financing.
- Exchange rates have been subject to increased national decision making since the breakdown of the Bretton Woods System in 1973. For historic and institutional reasons, exchange rate policy and trade policy have generally been dealt with separately in Canada and elsewhere. This practice cannot continue, given the link between the volume, pattern, and composition of trade, exchange rate levels and international debt issues. Trade, investment, finance and debt issues are increasingly linked in the contemporary international economy.

Canada is at a crossroads in terms of its trade policy. This fact reflects to a considerable degree the present state of the world economy and the role of the United States within it, as well as uncertainties about the future course of Canadian economic development. While Canada's basic trade policy objectives of strengthening the competitiveness and vigour of the Canadian economy and of assuring as large and stable access as possible to world markets remain sound, the balance among the various approaches to trade policy reviewed above will depend very much on the course of events over the next few years and the responses of other countries, especially the United States, to them.

## Notes

This paper was completed in January 1985, before the new Canadian government issued several important papers concerning future Canadian trade policy. The author thanks Frank Stone and Greg Meridith as well as two anonymous referees, for their most helpful comments.

1. These horizontal policy instruments are often broken down in the literature and in policy discussions into tariffs and non-tariff barriers or non-tariff measures. A more useful categorization might well be those actions which affect international trade that are taken at the border and those taken internally. See Grey (1982b, p.3) for a fuller discussion of this point.
2. The view that international economic subjects are less important than political or security relations permeates the work of many political economists including Spero (1977) and Kolko and Kolko (1972).
3. This point is made very clearly in Blackhurst (1981).
4. See, for example, Diebold (1980) and Reich (1983).
5. See, for example, Daly (1978) and Economic Council of Canada (1983).
6. See, for example, Hirsch (1976) for an informed discussion of this policy shift. See also Blackhurst, Marian, and Tumlrir (1978).
7. Daly (1982, pp. 11-12) among others, makes this point clearly, in his case from a Canadian perspective.



8. See Aho and Bayard (1982, pp. 382–84), see also Reich (1983).
9. Theories to explain this international migration of capital and production abroad are frequently associated with Raymond Vernon of the Harvard Business School but also with the neo-Marxist school of political science. See, for example, Vernon (1971), Tharakan (1979) or “Transnationals in the Capitalist World,” *World Marxist Review* 25 (April 1982): 56–62.
10. Perhaps the best study documenting this period is Gardner (1982).
11. Since many of these measures are not transparent, their impact on domestic economies and on international trade flows is sometimes extremely difficult to quantify. For a good analysis of the cost of protectionism, see Commonwealth Secretariat (1982). For an examination of the Canadian case, see Harris and Cox (1983).
12. See Corden (1971; 1984) and, for a Canadian application, Biggs (1980, pp. 116–37).
13. Largely because of U.S. insistence during the 1950s, agriculture has remained outside the provisions of the GATT.
14. The U.S. Administration has continued to give strong official support to a liberal trade system and has, with a few exceptions, strongly opposed a range of protectionist trade measures introduced in Congress. In addition, Japan appears to have accepted that it should move more quickly toward an open domestic economic system, a more liberal import regime, and a more hospitable view of foreign investment.
15. Direct foreign investment flows alone increased from US\$3.95 billion in 1960 to \$35.6 billion by 1980 (International Monetary Fund, 1984a, p. 50).
16. A strong case that exchange rates do affect trade policy has been made by Bergsten and Williamson (1983). Richardson, Krugman, and Emminger have also explored the interconnections between real and financial policies that affect international transactions. See, for example, Richardson (1983). See also IMF (1984b) and Williamson (1983).
17. A recent summary of the criticisms, particularly from the standpoint of a practitioner, can be found in two essays: Emminger (1983) and Roosa (1983). See also Williamson (1983) and Dunn (1983).
18. A good example of the official position is the intervention study prepared following the 1982 Western economic summit at Versailles. *Report of the Working Group on Exchange Market Intervention*, March 1982. See also Williamson (1983) for an analysis of the techniques and efficacy of exchange rate targeting.
19. One excessively pessimistic account, not restricted to the GATT itself, can be found in Jackson (1978). Two rather balanced accounts of the GATT following the Tokyo Round can be found in Grey (1982a) and in Commonwealth Secretariat (1983, pp. 92–106).
20. A very considered set of ideas concerning the strengthening of the GATT system is contained in Camps and Diebold (1983).
21. The treaty covered what were then termed “natural products,” but generally excluded manufactured products. For a comprehensive treatment of this treaty, see Masters (1936).
22. One can exaggerate slightly and suggest that the formation of Canada was an outcome of mid-19th century British and U.S. international trade policies.
23. See Phillips (1979). The classic work is Easterbrook and Aitken (1958).
24. See Canada, Department of External Affairs (1983a, chap. V, VI and VII). The new Special Import Measures Act designed to accomplish these objectives was adopted by Parliament in June 1984 and become effective December 1, 1984.
25. See Canada, Department of External Affairs (1983b, pp. 25–30).
26. Canada’s share of world exports has fallen from 5.1 to 3.6 percent over 1970–81. The size of Canada’s share of world exports and the magnitude of its decline over time vary slightly according to the source of information: see, for example *Financial Post*, September 15, 1984, pp. 1–2; *The Financial Times of Canada*, September 17, 1984, p. 9; and Canada, Department of External Affairs 1983a, p. 16. However, it should be added that comparisons of a country’s share of world exports over time can be misleading and are perhaps less relevant for policy purposes than changes in the composition, volume and direction of a country’s imports and exports.

27. Views on this subject from a Canadian perspective range from those of Safarian, including his "Foreign Investment and Industrial Behaviour: A Comment on 'the Weakest Link'" (1979), to those of Williams (1983).
28. See, for example, Cooper (1968), Keohane and Nye (1977), Kindleberger (1969) and Safarian (1984).
29. This discussion, therefore, does not encompass other approaches which might be suitable or feasible within other structures of systemic "order," such as hegemony, truly international government, or some form of oligarchy.
30. See Canada, Department of External Affairs (1983b, p. 138). It can be argued that countries with large import markets can more easily avoid their GATT obligations because they are less exposed to retaliation by countries which have small import markets or are heavily dependent on exports. However, it has also been argued that GATT rules and obligations serve to exert a degree of constraint on larger countries which could not be achieved in a bilateral relationship between a larger and a smaller country.
31. See, for example, Caves and Jones (1981, pp. 200–50).
32. The importance of removing foreign trade barriers in the case of a small country like Canada has been well demonstrated by Wonnacott and Wonnacott (1982).
33. Regarding unilateral tariff reductions for anti-inflationary reasons, see for example the 1974 and 1975 federal budgets. The actions taken for anti-inflationary reasons were in place only for short periods of time and were not bound by international agreement.
34. The literature on this subject is enormous. A comprehensive, non-technical review of the debate can be found in Canada, Department of External Affairs (1983a, pp. 109–13). Two other frequently cited references on this subject are Economic Council of Canada (1975), and Canada, Senate Standing Committee on Foreign Affairs (1982).
35. U.S. officials have stated publicly that they would be prepared to entertain and discuss any Canadian proposals in this respect; to date exploratory meetings have led to the identification by Canada of four possible sectors for bilateral trade liberalization: steel; agricultural machinery; traded computer services; and government procurement policies, with special emphasis on urban mass transit equipment. A joint Canadian–U.S. working group has been established for each of these. Each country has identified areas of potential further discussion. For Canada, these include petrochemicals, textiles and clothing, and meat; for the U.S., these include forest products, cosmetics, alcoholic beverages, furniture and heavy electrical equipment. See Bale (1984, pp. 2–4).
36. It should be noted that under existing U.S. legislation, including the Trade and Tariff Act of 1984, the Administration has authority to negotiate bilateral or multilateral agreements to reduce or eliminate tariff or non-tariff barriers. However, agreements reached under this authority would be subject to review by the U.S. Senate Finance Committee and the House Ways and Means Committee. Under some circumstances, further Congressional approval might be required.
37. Advocates of the imperial trade system used to envisage a east-west link between Great Britain, Canada, Australia, and New Zealand to counterbalance the United States.
38. H.E. (Ted) English is an important Canadian advocate of this option. See, for example, English (1983, pp. 330–53).
39. Regional trade meetings involving these and other countries have been going on for almost two decades. One organizational concept that has been advanced is that of the Pacific Free Trade Area (PAFTA).
40. Canada's trade across the Pacific surpassed that across the Atlantic for the first time in 1982. Canadian trade with less developed countries as a group exceeded Canadian trade with Western Europe for the first time also in 1982 (Statistics Canada, 1983a; 1983b).
41. The objective of the Asia Pacific Foundation of Canada is, among other things, to promote Canadian knowledge and understanding of the Asia Pacific region, particularly the growing cultural, social and economic impact of the region on world affairs and specifically on Canada.



42. Certain of the codes adopted at the Tokyo Round of Multilateral Trade Negotiations are binding only on the signatories. Although these signatories include most of the industrial nations and many of the developing countries, this is an example of conditional Most-Favoured Nation treatment in the GATT system. See Stone (1984, p. 186).
43. This sense has been conveyed often by the United States, recently in the context of reaching a bilateral agreement to liberalize trade with Israel, and possibly with Canada. In particular, emphasis has been given to the effect such arrangements could have as an example and an inducement to third parties. See, for example, Brock (1984), Bale (1984) and Medas (1984). Concepts involving trade groupings of less than full GATT membership, such as the "Super-GATT" or "GATT-Plus" are gaining some currency among like-minded nations as possible options for a more flexible multilateralism. For a more complete discussion of the options available to such a grouping, especially as regards selective action and differentiation, see Camps and Diebold (1983).
44. The specific Canadian case is developed at some length by Stone (1984). More generally, the capacity of smaller industrial countries to secure additional autonomy in trade and other policy matters is examined by Keohane (1982). A thoughtful, provocative position for Canada to adopt with respect both to its macro and micro international economic policy was advanced by Thurow (1983, pp. 63–65).
45. The latest GATT meeting, November 1984, again proved to be fractious. See *Financial Times of London*, November 27, 1984, p. 6, and November 28, 1984, pp. 1,6.

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## Notes from an Address on the Proposal of a Canada-Japan Free Trade Area

RONALD J. WONNACOTT

These notes provide a brief consideration of the question of initiating a Canada-Japan free trade area. Wouldn't such an agreement be very much in the Canadian interest, because of Japanese technology and because a substantial, though very far from dominant, part of Canada's trade is with Japan?

The broad answer can be sketched out before turning to technical details. A free trade area with Japan would offer some benefits to Canada, but these benefits would be limited by geography. The more distant a trading partner, the more the gains from trade are dissipated in transport costs. Benefits would also be limited because Canadian industry would continue to face great difficulties in marketing goods in the Japanese market, and these difficulties would not be dramatically reduced by our duty-free access to the Japanese market. Therefore, a Canada-Japan free trade area would be likely to continue the theme of our present relationship with Japan — the exchange of our resources for Japanese manufactured goods. Moreover, for reasons detailed at the end of this paper, such a preferential arrangement with Japan would put at risk what is by far the most important industrial export market that we now enjoy — that of the United States. Thus, Canadians would face the prospect of increased concentration on resource extraction. Such an increase may be far better than is often supposed, *provided* there is an open world economy in which countries are free to pursue their activities of comparative advantage, but that is not the situation under consideration here. Instead, Canada would be pressured in the direction of resource specialization because of increased problems in selling in the United States.

Even in the best of circumstances, a much heavier resource concentration by Canada would involve problems of adjustment for a displaced labour force in manufacturing. But in the far less attractive circumstances described here, with Canada pressured towards greater resource concentration because of damage to our major industrial export market, the problem would not be just one of temporary adjustment; there would also be a long run loss in potential income. In short, it is questionable that a substantial, forced move towards resource extraction would provide a broad enough base on which to build Canada's future. Any initiative we consider should offer the promise of broad industrial development as well.

It is worth asking what we should seek in a free trade partner. In a rapidly changing world economy in which we cannot be sure what our comparative advantage may be a decade or two from now, it is important to keep our options and future opportunities open. Accordingly, we should seek a partner that is wealthy, and able on other accounts as well, to absorb the widest possible range of our products, including both resources and manufactured goods. In addition, the prospective partner should be the least-cost source of many of our imports — the more, the better. It should be geographically close, so that gains from trade will not be dissipated in transport costs. Finally, it should be a country with which we already trade heavily. If it is not, then a tremendous burden is placed on the new association. Before providing any *net* gain, it would have to provide substantial benefits to offset the losses stemming from damage to our *existing* trade with third countries.

While no free-trade association with a single country completely satisfies all these requirements, the United States provides a far better fit as a partner than Japan. Indeed, because a Japanese association would put at risk a large part of our present gains from trade — those resulting from our trade with the United States — it is doubtful that on balance it would provide any net benefit at all, let alone a net benefit comparable to that offered by other trade initiatives.

It is important to recognize that the major opportunity for free trade gains from an association with Japan would come from our import of Japanese manufactured goods and the competition we would have to face in matching the technological excellence of Japanese products. But couldn't we acquire these advantages just by removing present restraints on our imports from Japan? The (somewhat oversimplified) answer is yes. In particular, we could start with our present import restraints that *discriminate against* the Japanese — in particular, the “voluntary” export restraints that limit the sales of Japanese autos in Canada. Although this would be only a relatively small policy change, it would provide a good preview of some of the effects of free trade with Japan. Moreover, it is the only major trade-liberalizing initiative we could take with Japan that would offer undiluted benefits free of the costs of



disrupting our trade with the United States.

This requirement that we not disrupt our trade with the United States is worth emphasizing. Because of the importance of this trade and the cost of a U.S. reaction, a key guideline in any Canadian trade initiative is that any major concession we offer to any other country must also be offered to the United States. This opens up an even more interesting possibility. Why not try to negotiate a free trade arrangement with both Japan and with the United States? In addition to the documented gains from free trade with the United States, estimated to be in the range of 5 to 10 percent of GNP, there would be additional, admittedly less substantial, gains from free trade with Japan. These gains would *not* be jeopardized by a U.S. reaction in this case since we would be giving both countries the identical preferred treatment. (The only risk would be that the inclusion of Japan might invoke a European reaction, a risk that might be reduced by extending an open-ended offer to the Europeans to participate.) Moreover, it is not necessary that Canada, the United States and Japan form a single free trade area. If the United States and Japan do not wish to trade freely with each other, Canada could consider a bilateral free trade arrangement with each. This suggestion goes beyond the scope of these notes, and has in any case been detailed elsewhere.

In the course of analysing the costs and benefits of a Canada-Japan free trade area that does not include the United States, we must recognize what is possibly the single most important consideration in evaluating this whole issue: Whether or not Canada might want such an association with Japan, the Japanese would not even consider it.

## **The Benefits to Canada of Canada-Japan Free Trade**

### ***Increased Export Opportunities***

In theory, there should be considerable opportunity for expanding our exports to Japan. In practice, however, this is not so clear. We already export a lot of resources to Japan. Free trade is unlikely to increase this dramatically, because Japanese barriers to our resources are already very low and cannot be greatly reduced. (The one exception is in agricultural goods and for political reasons there seems to be little prospect of decreased protection here.) In industrial goods the prospects for Canadian export increases are also limited. Japanese tariffs and *visible* non-tariff barriers (NTBs) that we might hope to negotiate down are relatively unimportant compared to their *invisible* NTBs, which often are difficult to identify, let alone negotiate down. These invisible NTBs include the wide variety of problems encountered in moving goods from the dock through, around, over or under the Japanese distribution system to the Japanese buyer. Language is only one of these problems.

In short, while some specific Canadian industries might gain substantial new export opportunities by special negotiated access to the Japanese market, a major across-the-board gain seems unlikely. We would continue to encounter the problems we now face in trying to sell manufactured goods in Japan. These problems, in addition to the invisible NTBs noted above, include the following. (a) When competing in Japan we would face a substantial transport cost disadvantage, compared to the advantage we enjoy when competing with the Japanese in Canada. (b) Because Japan must import natural resources, it tends to have an exchange rate that makes it hyper-competitive in the export of manufactured goods, in order to generate a large trade surplus in manufactures. Therefore all other countries must collectively have a large deficit in manufactures with Japan; Canada has such a deficit now. Although it is not impossible, it is not easy to achieve a dramatic increase in industrial exports to a country like Japan.

### ***Increased Industrial Imports from Japan***

In evaluating this potential Canadian benefit, a key question concerns the degree to which Japan is our least-cost source of supply for industrial goods. For products in which Japan does play this role, we can benefit from the elimination of Canadian trade barriers against Japan. There would be increased efficiency in consumption as Canadian buyers expand their purchases of bargain-priced Japanese goods, and there would be increased efficiency in production as imports from Japan displace our higher-cost domestically-produced goods. However, there would be a short-run adjustment cost in Canadian industrial employment stemming from this displacement, with little compensation in the form of increased employment stemming from expanded exports to Japan, for reasons already noted.

In goods in which Japan is not our lowest-cost source of supply, increased imports from Japan would bring a special kind of cost, in addition to some of the benefits cited above. We turn next to this question.

## **The Costs to Canada of Canada-Japan Free Trade**

### ***Trade Diversion Costs***

A cost to Canada would arise if Canadian consumers switched to Japanese goods from a lower-cost source of supply, such as the United States. Canadian consumers would find Japanese goods a better buy because they would come into Canada duty free while goods from other countries would have to pay a Canadian duty. But to the Canadian economy as a whole, taking into account duty revenues collected, the



U.S. good would still, in this case, be the better bargain. In a free trade area with Japan, this trade diversion cost to Canada could be substantial since, judging from present trade patterns, other countries are usually a less expensive source of supply than Japan. About 95 percent of our present imports come from countries other than Japan — 70 percent from the United States.<sup>1</sup> This indicates the wide domain of goods over which such potentially costly trade diversion might occur. In contrast, a Canada–U.S. free trade area would create a potential diversion for only about 30 percent of our imports — those now coming from countries other than the United States.

### *The Problem of Retaliation by the United States*

It should be emphasized that the trade diversion costs described above would exist even if our other trading partners did not react *in any adverse way whatsoever* to a free trade agreement between Canada and Japan. But such reaction could not be avoided. The reason is that the diversion of Canadian import purchases from the United States to Japan means lost U.S. export sales in Canada. Given the hostile reaction of the United States when the European Community negotiated free trade arrangements with bordering countries in the past, an even more hostile U.S. reaction can be expected to a similar arrangement between Canada and Japan since Canada is a vastly more important export market for the United States than any of the countries bordering the European Community. Any such American response against our exports could be extremely costly for Canada. For example, if the United States were to insist on renegotiating the Canada–U.S. Auto Pact alone, the cost to Canada could exceed all the benefits of a free trade area with Japan. Moreover, such a U.S. reaction is certain because sales of U.S.-produced autos in Canada would no longer be protected from the Japanese. In short, a major problem in establishing a free trade area with Japan is that it would disturb our highly beneficial existing trade with the United States. This would be so even if the United States did not retaliate, and in the virtually certain event of U.S. retaliation the costs could become vastly greater.

U.S. hostility would be directed not just at Canada but at Japan as well. This is the ultimate reason why a Canada–Japan free trade area is out of the question. Such a suggestion would be flatly turned down by the Japanese. They cannot be expected to jeopardize their much more important trade with the United States simply to gain marginal advantages from increased trade with Canada.

## Concluding Observations

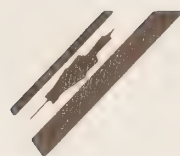
Our final note is this: Wouldn't there be great benefits from a closer association with a country that is technologically the "gold medalist"? The answer is: Yes, other things being equal. But other things are not equal. As noted above, a free trade association with Japan would have serious costs in terms of disrupting our present trade. Moreover, we do not have to trade freely to take advantage of Japanese technology. Technological transfers readily occur across tariff-ridden borders. (Despite their lack of a free trade arrangement with *anyone*, Japan has done very well in exploiting technological advances made elsewhere.) And are we sure that the Japanese are technologically the gold medalists? The answer is not clear, as we can see from the example used to argue for Japanese supremacy: Japan may now be the world's best in using robotics to produce cars, but much of the initial design and development of these robots occurred in the United States.

## Notes

This paper was completed in October 1984. For a more complete and polished statement of some of the ideas incorporated here, see R.J. Wonnacott, *Canada's Trade Options* (Ottawa: Economic Council of Canada, 1975).

1. Although only about 5 percent of our present imports are from Japan, this figure understates the degree to which Japan is the lowest cost source of supply. Specifically this figure is biased downward because of trade in autos, where Canada discriminates against Japan and gives preference to the United States under the Auto Pact.





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